TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1916.

No. 475.

WILLIAM McCOACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

INSURANCE COMPANY OF NORTH AMERICA.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

PETITION FOR CERTIORARI FILED MAY 5, 1916.
CERTIORARI AND RETURN FILED JUNE 12, 1916.

(25281)

SUPREME COURT OF THE UNITED STATES.

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INDEX.

DOCKET ENTRIES.

IN THE

UNITED STATES DISTRICT COURT,

EASTERN DISTRICT OF PENNSYLVANIA.

December Term, 1912.

G. W. Pepper	Insurance Company of North America
2402	vs.
F. F. Kane	William McCoach, Collector of Internal Revenue

1913	Jan.	29	Praecipe for summons filed.
			Summons exit returnable the first Monday of Febry. next.
			Statement of claim filed.
			Rule to file an affidavit of defence filed.
"	Feby.	3	Summons returned served and filed.
"	"	4	Proof of service of statement of claim and rule to file an affidavit of defence filed.
"	Nov.	19	Amended statement of claim filed.
			Rule to file an affidavit of defence filed.
1914	Feby.	25	Affidavit of defence filed.
"	"	26	Plea filed.
"	May	14	Order to place case on trial list filed.
2"	Oct.	29	Stipulation for trial before Court without a jury, filed.
			Trial before the Court without a jury.
"	Dec.	7	Opinion, Dickinson, J., granting Judgment for plaintiff for $192.73 filed.
			Testimony taken in open Court filed.
"	"	17	Bill of Exceptions sealed and filed.
"	"	22	Praecipe for judgment filed. Judgment accordingly.
			Judgment filed.

Assignments of error filed.
Petition for writ of error filed.
Order allowing writ of error filed.
Citation allowed and issued.
Citation returned "service accepted" and filed.
Writ of error allowed and copy thereof lodged in Clerk's office for adverse party.

UNITED STATES OF AMERICA, ss.

THE PRESIDENT OF THE UNITED STATES,

To the Honorable the Judge of the District Court of the United States for the Eastern District of Pennsylvania:

GREETING:

BECAUSE in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, or some of you between Insurance Company of North America, plaintiff, and William McCoach, Collector of Internal
3 Revenue, defendant, a manifest error hath happened, to the great damage of the said Insurance Company of North America, plaintiff, as by its complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Third Circuit, together with this writ, so that you have the same at the City of Philadelphia within thirty days, in the said United States Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States should be done.

WITNESS the Honorable Edward D. White, Chief Justice of
[SEAL.] the Supreme Court of the United States, at Philadelphia, the 22nd day of December in the year of our Lord one thousand nine hundred and fourteen.

GEORGE BRODBECK,
Deputy Clerk of the District Court of the United States.

Before DICKINSON, *J.*

Allowed:
BY THE COURT,
Attest:
GEORGE BRODBECK,
Deputy Clerk.

IN THE

4

UNITED STATES DISTRICT COURT,

FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

No. 2402. Dec. Term, 1912.

INSURANCE COMPANY OF NORTH AMERICA.

vs.

WILLIAM McCOACH, Collector of Internal Revenue.

PLAINTIFF'S AMENDED STATEMENT OF CLAIM.

Filed Nov. 19, 1913.

The Insurance Company of North America, a corporation duly formed and existing under the laws of the Commonwealth of Pennsylvania, brings this suit to recover from the defendant, William McCoach, the sum of Two thousand eight hundred sixteen dollars and eighty-one cents ($2,816.81) with interest thereon from August 22, 1912, upon the cause of action whereof the following is a statement:

1. The defendant, William McCoach, was at all times hereafter mentioned and still is the Collector of Internal Revenue for the Eastern District of Pennsylvania, being duly commissioned as such pursuant to the laws of the United States. The plaintiff was at all times hereafter mentioned and still is engaged in the business of fire and marine insurance.

2. On or about, or prior to the fifteenth day of August, 1912, the United States Commissioner of Internal Revenue, presuming to act by virtue of due legal authority conferred by the Act of Congress of August 9, 1909, imposing a special excise tax on corporations,

5 assessed against plaintiff as an insurance company engaged in business in Pennsylvania, an additional, special excise tax amounting to Eight thousand eight hundred seventy-five dollars and ninety-one cents ($8875.91) upon annual net income for the year 1910 and an additional special excise tax amounting to One thousand and seventy-two dollars and thirty-five cents ($1,072.35) upon annual net income for the year 1911 alleged to be due from the plaintiff to the United States.

3. The lists upon which the tax assessment appeared were thereafter duly transmitted to the defendant as collector aforesaid. The

defendant thereupon made formal demand upon the plaintiff for the payment of said taxes, and served upon the plaintiff notices of, and demands for, said taxes. Copies of the said notices and demands are hereto annexed and marked Exhibits "A" and "B" respectively. About the time of the service of the said notices and demands upon the plaintiff, the plaintiff was informed by defendant that if plaintiff refused to pay the taxes so assessed defendant would collect the said taxes by distraint and sale of plaintiff's property.

4. On August 22, 1912 plaintiff paid to defendant the amount of the additional tax assessed against it for the years 1910 and 1911 as aforesaid and at the time of said payments plaintiff filed with defendant written protests, copies of which are hereto annexed marked Exhibit "C." Defendant gave to plaintiff written receipts for the sums so paid, to wit, Eight thousand eight hundred seventy-five dollars and ninety-one cents ($8875.91) for the year 1910 and One thousand and seventy-two dollars and thirty-five cents ($1,072.35) for the year 1911. Copies of the receipts are hereto annexed marked Exhibits "D" and "E" respectively.

5. On or about October 15, 1912 plaintiff filed with defendant a claim for refund of the said taxes so paid in so far as they were
6 then believed to be excessive and illegal, to wit, to the extent of Two thousand three hundred five dollars and fifty-three cents ($2,305.53) for the year 1910 and Nine hundred seventy-two dollars and thirty-eight cents ($972.38) for the year 1911. A copy of the said claim for refund is hereto annexed marked Exhibit "F". The said claim for refund was accepted by defendant. After consideration of the said claim for refund of the said excessive tax assessments, the Commissioner of Internal Revenue rejected the same. Under date of September 7, 1912, defendant sent to plaintiff a letter giving the reasons for such rejection. A copy of said letter is hereto annexed marked Exhibit "G."

6. Plaintiff now avers that the said taxes to the extent of One thousand six hundred dollars and fifty-three cents ($1,600.53) for the year 1910 and One thousand two hundred sixteen dollars and thirty-eight cents ($1,216.38) for the year 1911 were excessive and unjustly and illegally assessed against plaintiff by the Commissioner of Internal Revenue and were illegally and wrongfully collected from plaintiff by defendant as Collector as aforesaid for the reasons hereinafter set forth.

7. The amount upon which the said assessment for the year 1910 was made up included the following items:

tax assessed upon net additional required by law to be made within the year to reserve funds for losses	$151,750.00
tax assessed on accrued but unpaid interest on bonds not received by the company during the year for which the tax was assessed	$8,303.41
	$160,053.41

7 The said items were improperly and illegally, and without warrant in law, included by said Commissioner of Internal Revenue in the amount upon which the said assessment for the year 1910 was made. One per cent. (1%) of the sum of the said items so improperly and illegally included amounts to $1600.53.

8. The amounts upon which the said assessment for the year 1911 was made up include

tax assessed upon net additional required by law to be made within the year to reserve funds for losses-----	$113,000.00
Taxes assessed on accrued but unpaid interest on bonds not received by the company during the year for which the tax was assessed----------	$8,638.83
	$121,638.83

The said items were improperly and illegally, and without warrant at law, included by the said Commissioner of Internal Revenue in the amount upon which the said assessment for the year 1911 was made. One per cent. (1%) of the sum of the said items so improperly and illegally included amounts to $1216.38.

9. As above set forth, plaintiff avers that it was illegally taxed upon net additions required by law to be made to reserve funds for losses in 1910, $1517.50; in 1911, $1130.00. The said figures are arrived at as follows:

(a) In the annual reports of the plaintiff to the Insurance Commissioner of Pennsylvania in the form required by law for the years 1909, 1910 and 1911 there appeared under the head of "LIABILITIES" the following items:

8 1909 "LIABILITIES (a) FIRE MARINE and INLAND.

1. Gross Losses adjusted and unpaid (due $; not yet due $)	$96,981.01	----------	
2. Gross Claims for Losses in process of adjustment, or in suspense, including all reported and supposed Losses, ----------	387,822.12	$483,200.00	
3. Gross Claims for Losses resisted----	23,776.87	----------	
4. TOTAL----------	$508,580.00	$483,200.00	
5. Deduct re-insurance due or accrued (give list of Companies and amounts), as per Schedule E, $48,730.00; and salvage claims, $65,800.00----------	48,730.00	65,800.00	
6. Net amount of Unpaid Losses and Claims ----------	$459,850.00	$417,400.00	$877,250.00"

1910 "LIABILITIES (a) FIRE MARINE and INLAND.

1. Gross Losses adjusted and unpaid (due $; not yet due, $)	$106,526.11		
2. Gross Claims for Losses in process of adjustment, or in suspense, including all reported and supposed Losses	410,212.57	$590,000.00	
3. Gross Claims for Losses resisted	25,396.32		
4. TOTAL	$542,135.00	$590,000.00	
9 5. Deduct re-insurance due or accrued (give list of Companies and amounts), as per Schedule E, $32,635.00	32,635.00		
6. Net amount of Unpaid Losses and Claims	$509,500.00	$590,000.00	$1,099,500.00

1911 "LIABILITIES (a) FIRE MARINE and INLAND.

1. Gross Losses adjusted and unpaid due, $; not yet due, $)	$151,824.71		
2. Gross Claims for Losses in process of adjustment or in suspense, plus $25,000.00 reserved for losses incurred prior to December 31, of which no notice had been received on that date	$427,866.07	$670,100.00	
3. Gross claims for Losses resisted	26,994.22		
4. TOTAL	$606,685.00	$670,100.00	
5. Deduct re-insurance due or accrued (give list of Companies and amounts) as per Schedule E	88,685.00		
6. Net amount of Unpaid Losses and Claims	$518,000.00	$670,100.00	$1,188,100.00

10 (b) In pursuance of a ruling of the Insurance Commissioner of the State of Connecticut, plaintiff, in its annual report to the Insurance Departments of the various States for the year 1910 did not deduct the amount of salvage claims for the year 1910 from the net amount of its unpaid losses and claims, as had been done in the report for the year 1909. The amount of salvage claims for the year 1910 was Seventy thousand five hundred dollars ($70,500).

(c) In preparing plaintiff's return to the Commissioner of Internal Revenue for 1910, plaintiff, in arriving at the increase in the

amount of unpaid losses for 1910 over 1909, deducted from the net amount of unpaid losses and claims for 1910 as shown by the report to the Insurance Department of Pennsylvania as above set forth---------- $1,099,500.00
the amount of salvage claims for 1910---------- $70,500.00

thus making the net amount of unpaid losses and claims for 1910---------- $1,029,000.00
From which was deducted the net amount of unpaid losses and claims as shown by plaintiff's report to the Insurance Department of Pennsylvania for 1909, as above set forth---------- 877,250.00

$151,750.00

The said sum of $151,750.00 was included by plaintiff in its original return of net income made to defendant for 1910 in Item 5 (a) thereof.

(d) The Government amended plaintiff's original return for the year 1910 as follows:

(1) By transferring from Item 5(a) thereof to Item 5(c) thereof the deductions claimed by plaintiff under the former item.

11 2. By refusing to allow as a deduction the aforesaid sum of $151,750.00 which had been included by plaintiff as part of its losses for the year 1910 under Item 5(a) of the return.

3. By making certain other adjustments not here in dispute which reduced the amount of deduction claimed by plaintiff under Item 5(a) of its original return from---------- $4,795,221.24
to ---------- $4,651,913.91
allowed by the Government as a deduction of Item 5(c) of the amended return.

(e) As the result of the action of the Government in disallowing the said deduction of $151,750.00 plaintiff was required to pay and paid under protest, an additional tax of $1,517.50.

(f) After having paid this tax of $1,517.50 under protest, plaintiff prepared its claim for refund of which a copy is hereto annexed marked Exhibit F. In preparing its claim plaintiff overlooked the fact that in making up its original return to the Commissioner of Internal Revenue, it had deducted from the net amount of unpaid losses for 1910, as shown by report to the Insurance Department of Pennsylvania for that year---------- $1,099,500.00
the amount of salvage claims for that year---------- 70,500.00

$1,029,000.00

before it subtracted therefrom the net amount of unpaid losses and claims for 1909, as shown by report to Insurance Department of Pennsylvania for a year-- $877,250.00

$151,750.00

in order to arrive at the increase in unpaid losses and claims for 1910 over 1909.

12 (g) Plaintiff, as the result of this oversight, took the amount of unpaid losses and claims as shown by the 1910 report to the Insurance Department of Pennsylvania-- $1,099,500.00
and subtracted therefrom the amount of unpaid losses and claims shown by the 1909 report to the Insurance Department of Pennsylvania---------- 877,250.00

and averred in its claim for refund that it had been illegally assessed upon---------- $222,250.00
whereas the illegal assessment was in fact upon the sum of $151,750.00 as above set forth.

(h) The amount of plaintiff's claim, as set forth in the claim for refund filed with the Commissioner of Internal Revenue is therefore reduced, as the result of this mistake, for 1910 from $2,305.53 to $1,600.53.

(i) In plaintiff's original return to the Commissioner of Internal Revenue for 1911 it made a deduction of $5,185,530.32 under Item 5(a) thereof. This sum was arrived at by taking the net amount of unpaid losses and claims for 1911, as shown by plaintiff's report to the Insurance Department of Pennsylvania------ $1,188,100.00
and deducting therefrom the amount of salvage claims for 1911---------- 46,100.00

$1,142,000.00
From which was subtracted the net amount of unpaid losses and claims for 1910, as shown by plaintiff's report to the Insurance Department of Pennsylvania, after deducting salvage claims for that year------ 1,029,000.00

Thus showing an increase in unpaid losses and claims for 1911 over 1910, or---------- $113,000.00
13 which sum was included in plaintiff's original return as a deduction under Item 5(a) thereof, as above set forth.

(j) The Government amended plaintiff's return as follows:

1. By transferring from Item 5(a) thereof to Item 5(c) thereof the deductions claimed by plaintiff under the former item.

2. By refusing to allow as a deduction the aforesaid sum of $113,000.00 which had been included by plaintiff as part of its losses for the year 1910 under Item 5(a) of the return.

3. By making certain other adjustments not here in dispute which reduced the amount of deduction claimed by plaintiff under Item 5(a) of its original return from---------- $5,185,530.32
to---------- 5,118,502.53
allowed by the Government as a deduction of Item 5(c) of the amended return.

(k) As the result of the action of the Government in disallowing the said deduction of $113,000.00 plaintiff was required to pay and paid under protest, an additional tax of $1130.00.

(l) After having paid this tax of $1130.00 under protest plaintiff prepared its claim for refund of which a copy is hereto annexed marked Exhibit F. In preparing its claim plaintiff overlooked the fact that in making up its original return to the Commissioner of Internal Revenue, it had deducted from the net amount of unpaid losses of 1911, as shown by report to the Insurance Department of Pennsylvania for that year---------- $1,188,100.00
the amount of salvage claims for that year---------- 46,100.00

$1,142,000.00

14 and that it had deducted from net amount of unpaid losses for 1910 as shown by report to the Insurance Department of Pennsylvania---------- $1,099,500.00
the amount of salvage claims for that year---------- 70,500.00

$1,029,000.00

$113,000.00

(n) Plaintiff, as the result of this oversight, simply took the net amount of unpaid losses and claims for 1911 as shown by report to the Insurance Department of Pennsylvania for that year---------- $1,188,100.00
and deducted therefrom the net amount of unpaid losses and claims for 1910, as shown by report for that year---------- 1,099,500.00

$88,600.00

The amount of deduction claimed by plaintiff in its original return and disallowed by the Commissioner of Internal Revenue was---------- $113,000.00
The amount which by mistake plaintiff in its claim for refund alleged to have been illegally assessed for taxation was---------- 88,600.00

The amount alleged in the claim for refund to have been illegally assessed was, therefore---------- 24,400.00
less than it should have been had the plaintiff not made the mistake above set forth.

(o) It therefore appears that plaintiff was illegally assessed upon the $113,000.00 instead of upon $88,600.00 and that the amount of tax illegally assessed against and paid by plaintiff under
15 protest on this item for 1911, was---------- $1130.00
instead of---------- $886.00

and the plaintiff's claim against defendant upon this item for 1911 is, therefore, increased $244.00

(p) As above set forth plaintiff's claim upon this item for 1910 is reduced as the result of error $705.00
and increased for 1911 ..... 244.00

making a net reduction in the amount of plaintiff's total claim in this suit from the amount set forth in the claim for refund, of $461.00

(q) Plaintiff alleges that the said sums of $151,750.00 for 1910 and $113,000.00 for 1911 were net additions required by law to be made within the respective years to reserve funds.

(r) The Act of the Pennsylvania Legislature, 23rd June, 1885, (P. L. 134) provides in Section 1, that:

"Every insurance company, including individuals, partnerships, joint stock associations and corporations, conducting any branch of insurance business in this State, must transmit to the insurance commissioner a statement of its condition and business for the year ending on the preceding 31st day of December, which statement shall be rendered on the first day of January following, or within sixty days thereafter, except that foreign companies shall transmit their statement of business, other than that done in the United States prior to the following first day of July following or within sixty days thereafter; which statements must be in form and state the particulars required by the blanks prescribed by the commissioner."

16 The Act of Pennsylvania Legislature of first of June, 1911, (P. L. 616) provides in Section 15, that:

"Every insurance company shall annually, on or before the first day of March, file in the office of the insurance commissioner a statement which shall exhibit its financial condition on the 31st day of December of the previous year, and its business of that year. The commissioner shall annually furnish to each of the insurance companies authorized to do business in this commonwealth blanks, in such form as he may adopt, for their annual statements; and he may make such changes, from time to time, in the form of the same as shall seem to him best adapted to elicit from them a true exhibit of their financial condition."

(s) In accordance with the requirements of the above laws, the Insurance Commissioner of Pennsylvania did, in the years 1910 and 1911 require plaintiff and all insurance companies doing business in Pennsylvania to file annual reports upon forms prepared by him. In such reports plaintiff, together with the other companies, was required to carry as a liability for reserve the net estimated amount of unpaid losses and claims. The Insurance Commissioner of Pennsylvania, and fire insurance experts and actuaries generally consider unpaid losses and claims as outstanding policy obligations and as properly represented in the reserve fund of the company.

POOR C

10. The annual report of plaintiff to insurance commissioner of Pennsylvania and other states for the year 1909, under the head of "Non Ledger Assets" contained the following items:

"NON-LEDGER ASSETS."

17	Interest due, $890.00 and accrued, $2,140.82 on Mortgages, per Schedule B,	$3,030.82
	Interest due, NONE, and accrued, $57,873.52, on Bonds, per Schedule D, Part I,	57,873.52
	TOTAL	$60,904.34"

The annual report of plaintiff to insurance commissioner of Pennsylvania and other states for the year 1910, under the head of "Non-Ledger Assets" contained the following items:

"NON-LEDGER ASSETS."

Interest due, $310.00 and accrued, $2,230.80, on Mortgages, per Schedule B,	$2,540.80
Interest due, NONE, and accrued $66,666.95, on Bonds, per Schedule D, Part 1,	66,666.95
TOTAL	$69,207.75"

The annual report of plaintiff to insurance commissioner of Pennsylvania and other states for the year 1911, under the head of "Non-Ledger Assets" contained the following items:

"NON-LEDGER ASSETS."

Interest due, $923.12 and accrued, $2,083.28, on Mortgages, per Schedule B,	$3,006.40
Interest due, NONE, and accrued, $74,840.18, on Bonds, per Schedule D, Part 1,	$74,840.18
TOTAL	$77,846.58"

18 (a) In plaintiff's original return to the Collector of Internal Revenue for the year 1910 it did not include in gross income any part of the interest which was due and accrued but unpaid upon December 31st of that year.

(b) The Commissioner of Internal Revenue amended plaintiff's return for the said year of 1910 by adding to gross income the increase in the total amount of interest due and accrued for the year 1910 over the year 1909, to wit: Eight Thousand, three Hundred and three and 41/100 Dollars ($8,303.41) and assessed an additional tax against plaintiff for the year 1910 of Eighty Three Dollars and Three cents ($83.03).

(c) In plaintiff's original return to the Collector of Internal Revenue for the year 1911 it did not include in gross income any part of the interest which was due and accrued but unpaid upon December 31st of that year.

(d) The Commissioner of Internal Revenue amended plaintiff's return for the said year of 1911 by adding to gross income the increase in the total amount of interest due and accrued for the year 1911 over the year 1910, to wit: Eight Thousand, Six Hundred and Thirty-eight and 83/100 Dollars ($8,638.83) and assessed an additional tax against plaintiff for the year 1911 of Eighty-Six Dollars and Thirty-eight cents ($86.38).

11. Annexed hereto are copies of plaintiff's original returns for the years 1910, 1911 with the amended figures placed thereon by the Government. The amended figures appear in red ink. Said copies marked Exhibits H and I respectively.

12. Plaintiff is advised, believes and therefore avers, that there existed no warrant in law for the assessment by the said
19 Commissioner of the said additional special excise taxes to the extent to which they are alleged to be excessive; to wit, for the year 1910 $1600.53, and for the year 1911 $1216.38; and especially that there existed no warrant in law for demanding the said excessive taxes so assessed, there being no statute, or law of the United States Congress imposing such taxes upon the plaintiff.

13. Wherefore plaintiff brings this suit to recover from defendant the amount of the said excessive taxes so assessed and collected as aforesaid, to wit, Two thousand, eight hundred and sixteen and 91/100 dollars ($2,816.91) with interest thereon from August 22, 1912.

G. W. PEPPER,
Per B. F. Pepper,
Attorney for Plaintiff.

COMMONWEALTH OF PENNSYLVANIA,
COUNTY OF PHILADELPHIA. } *ss.*

T. HOUARD WRIGHT, being duly sworn according to law, deposes and says that he is the Secretary of the Insurance Company of North America, the plaintiff above named, and that the facts set forth in the foregoing statement as the basis of claim are true.

T. HOUARD WRIGHT.

Sworn and subscribed before me this 17th day of November, 1913.

[SEAL.] THOS. A. MACDONALD,
Notary Public.

Commission expires Jan. 16, 1917.

POOR COPY

20 EXHIBIT "A."

NOTICE OF AND DEMAND FOR TAXES ASSESSED.

UNITED STATES INTERNAL REVENUE,
Office of the Collector of Internal Revenue.
First District, State of Penna.
Phila., Aug. 15th, 1912.

List for Month of Aug. 1912.
Div. Corptn.
Insurance Co. of North America,
232 Walnut St., Phila.

You are hereby notified that a tax, under the Internal-Revenue Laws of the United States, amounting to $8,875.91, the same being an additional tax upon Annual Net Income, 1910, has been assessed against you by the Commissioner of Internal Revenue, and transmitted by him to me for collection. Demand is hereby made for this tax. This tax is due and payable on or before the 25th day of August, 1912, and unless paid within ten days after this notice and demand it will become my duty to collect the same with a penalty of five per centum additional, and interest at one per centum per month.

Payment may be made to W. McCoach, at Philada.

W. McCoach, Collector.

Payment must be in currency, postal money order, or certified checks.

BRING THIS NOTICE WITH YOU.

EXHIBIT "B."

NOTICE OF AND DEMAND FOR TAXES ASSESSED.

UNITED STATES INTERNAL REVENUE.
Office of the Collector of Internal Revenue,
First District, State of Penna.
Phila., Aug. 15th, 1912.

21

List for Month of Aug., 1912
Div. Corptn.
Insurance Co. of North America,
232 Walnut St., Phila.

You are hereby notified that a tax, under the Internal-Revenue Laws of the United States, amounting to One Thousand, Seventy-

two 35-100 Dollars, the same being an additional tax upon Annual Net Income, 1911, has been assessed against you by the Commissioner of Internal Revenue, and transmitted by him to me for collection. Demand is hereby made for this tax. This tax is due and payable on or before the 25th day of August, 1912, and unless paid within ten days after this notice and demand it will become my duty to collect the same with a penalty of five per centum additional, and interest at one per centum per month.

Payment may be made to W. McCoach, at Philada.

W. McCoach, Collector.

Payment must be in currency, postal money order, or certified checks.

BRING THIS NOTICE WITH YOU.

EXHIBIT "C."

August 22, 1912.

William McCoach, Esq.,
United States Internal Revenue Collector,
Post Office Building, Philadelphia.

Dear Sir:

We hand you herewith certified check to your order for $8875.91. The payment represented by this check is a payment made in response to the Government's demand for an additional special excise tax upon the annual net income of the Insurance Company of North America for the year 1910.

22 The payment of the above is made solely because of the Government's demand and threat of collection. Payment is made under protest because the assessment of the taxes was illegal and their collection is illegal.

Respectfully yours,

INSURANCE COMPANY OF NORTH AMERICA.

August 22, 1912.

William McCoach, Esq.,
United States Internal Revenue Collector,
Post Office Building, Philadelphia.

Dear Sir:

We hand you herewith certified check to your order for $1072.35. The payment represented by this check is a payment made in response to the Government's demand for an additional special excise tax upon the annual net income of the Insurance Company of North America for the year 1911.

The payment of the above is made solely because of the Governments demand and threat of collection. Payment is made under

protest because the assessment of the taxes was illegal and their collection is illegal.

Respectfully yours,

INSURANCE COMPANY OF NORTH AMERICA.

EXHIBIT "D."

No. B 271975.

UNITED STATES INTERNAL REVENUE,
Collector's Office, First District of Penna.
Philada., August 22nd, 1912.

RECEIVED OF Insurance Co. of North America Eight Thousand, Eight Hundred, Seventy-five 91-100 Dollars, Tax on Addit'l Special Excise Tax 1910---------- $8,875.91
Five per cent penalty Interest, for months

Total---------- $8,875.91
23 said amount of Tax being assessed on Corporation list for July, 1912.
$8,875.91

Wm. McCoach, Collector.
JWT

EXHIBIT "E."

No. B 271976

UNITED STATES INTERNAL REVENUE,
Collector's Office, First District of Penna.
Philada., August 22nd, 1912.

RECEIVED OF Insurance Co. of North America, One thousand Seventy-two and 35-100 Dollars, Tax on Additional Special Excise Tax 1911---------- $1,072.35
Five per cent penalty Interest, for months

Total---------- $1,072.35
said amount of Tax being assessed on Corporation list for July, 1912.
$1,072.35

Wm. McCoach, Collector.
JWT

EXHIBIT "F".

STATE OF PENNSYLVANIA, }
COUNTY OF PHILADELPHIA, } *ss.*

T. Houard Wright, of the City of Philadelphia in the State and County aforesaid, being duly sworn according to law, deposes and

says that he is the Secretary of the Insurance Company of North America, a corporation of the State of Pennsylvania, and that the said corporation was engaged in the business of Fire and Marine Insurance; that upon the 15th day of August A. D. 1912, the
24 said corporation was assessed an additional, special, excise, internal revenue tax of $8,875.91 with respect to the carrying on or doing of business by said corporation during the year 1910, and an additional, special, excise internal revenue tax of $1,072.35 with respect to the carrying on or doing business by said corporation during the year 1911, both under the Act of Congress of August 5, 1909, which amounts the said corporation afterwards, on the twenty-second day of August, 1912, paid to William McCoach, Esq., Collector of Internal Revenue for the First District of Pennsylvania, and of which $2,305.53, for the year 1910 and $972.38 for the year 1911, as this deponent verily believes, should be refunded for the following reasons, viz:

Because to the extent of the sums last mentioned, the assessment of said additional, special, excise, internal revenue tax was illegal and its collection was illegal. The said sum for the year 1910 is made up of the following items:

Tax assessed upon net addition required by law to be made within the year to reserve funds for losses	$222,250.00
Tax assessed on accrued but unpaid interest on bonds not received by the Company during the year for which the tax was assessed	8,303.41
	$230,553.41
One per cent. of said total	$2,305.53

The said sum for the year 1911 is made up of the following items:

Tax assessed upon net addition required by law to be made within the year to reserve funds for losses	$88,600.00
Tax assessed on accrued but unpaid interest on
25 bonds not received by the Company during the year for which the tax was assessed	8,638.83
	$97,238.83
One per cent. of the said total	$972.38

And this deponent now claims that by reason of the payment of the said sums of $8,875.91 and $1,072.35 (in all $9,948.26), the said corporation is justly entitled to have the sum of $3,277.91 refunded and it now asks and demands the same.

And this deponent further makes oath that the said claimant is not indebted to the United States in any amount whatever, and that no claim has heretofore been presented for the refunding of the above amounts or any part thereof.

Sworn to and subscribed before me
this day of October, 1912.

EXHIBIT "G".

TREASURY DEPARTMENT, Internal Revenue Service,
Philadelphia, Pa., December 7, 1912.

Insurance Company of North America,
232 Walnut Street,
Philadelphia, Pa.

Sirs:

Referring to your claim for the refunding of $3,278.91, special excise taxes for 1910 and 1911, I have to advise you that the Commissioner of Internal Revenue has rejected the same, and I enclose herewith four Forms 1, showing the payment of taxes for 1910 and 1911, in the following amounts:

$10,301.43
8,875.91
9,202.53
1,072.35

26 This claim is based upon two contentions, 1st, that a further deduction from gross income should be made because of net addition to reserves, and, 2d, that interest accrued but not received should not be included in gross income.

When the final assessments against this corporation were made on the June, 1912, list, deductions were allowed from gross income of such net additions to reserves as had been made during three years in conformity with the laws of Pennsylvania. The figures adopted were reported by Revenue Agent Fletcher, after investigations, and were confirmed by the reports of the Insurance Commissioner of Pennsylvania. Under these circumstances, no increase in these amounts appears to be allowable.

In regard to the accrued interest included in gross income, this was done in conformity with the method that has been applied in determining the gross income of all insurance companies, and, in fact, of all other corporations as well. Ultimately the corporation can suffer no injustice through the use of this method, for should this accrued interest be not received, the corporation is entitled to deduct it from gross income as loss, in the year in which the loss is ascertained and entered upon the corporation's books.

Respectfully yours,

W. McCoach,
Collector.

Enclosures.
Four Forms 1.

27

EXHIBIT "H".

UNITED STATES INTERNAL REVENUE.

Card Apr. 22/11
card corrected
Additional Assessment
July 1912 List
P. 1 L. 7
Fletcher
4/15/1912

RETURN OF ANNUAL NET INCOME.

(Section 38, Act of Congress approved August 5, 1909)

INSURANCE COMPANIES.

RETURN OF NET INCOME Received During the Year Ending December 31, 1910, by Insurance Company of North America, a corporation, the principal place of business of which is located at (Street and No.) 232 Walnut Street, City or Town of Philadelphia, in the State of Pennsylvania:

1. Total amount of paid-up capital stock outstanding at close of year		$4,000,000.00
2. Total amount of bonded and other indebtedness outstanding at close of year		$1,131,576.75
3. Gross Income (see Note A)		$9,619,677.44
		$10,046,753.82
DEDUCTIONS.		
4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation EXCLUSIVE OF INTEREST PAYMENTS. (See Note B)	$3,155,015.56	$3,107,935.30
5. (a) Total amount of losses sustained January 1 to December 31 not compensated by insurance or otherwise	$4,795,221.24	$8,643.99
28 (b) Total amount of depreciation January 1 to December 31	$8,241.38	$522.27
(c) Total amount other than dividends paid within the year on policy and annuity contracts	$0	$4,651,913.91
(d) Total amount of net addition required by law to be made within the year to reserve fund	$311,992.27	xx

6. Total amount of interest paid January 1 to December 31 on an amount of bonded and other indebtedness not exceeding the amount of paid-up capital stock outstanding at the close of the year	$0	
7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof	$191,645.68	$232,585.64
(b) Foreign taxes paid	$0	
8. Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations and insurance companies subject to this tax	$122,418.75 O.K.	122,418.75
		8,124,019.86
TOTAL DEDUCTIONS (see Note B)		$8,584,534.88
		$1,922,733.96
9. NET INCOME		$1,035,142.56
10. Specific deduction from net income allowed by law		$5,000.00
		$1,917,733.96
29 11. Amount on which tax at 1 per centum is to be calculated for assessment		$1,030,142.56
Additional Income		$887,591.40
" tax		$8,875.91

F. B.

State of Pennsylvania, County of Philadelphia, to wit:

Eugene L. Ellison, President, and T. Houard Wright, Secy-Treasurer of the Insurance Company of North America, corporation, whose return of annual net income is set forth above, being severally duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct in each and every particular: that the amount of gross income therein set forth is the full amount of gross income, without any deduction whatsoever, received from all sources by the said corporation during the year stated, and that the net income therein set forth is the full amount by which to measure the tax at 1 per centum for assessment.

(Signed) Eugene L. Ellison
President.

(Signed) T. Houard Wright,
Treasurer.

SWORN AND SUBSCRIBED to before me this 21st day of February, 1911.

Thos. A. MacDonald,
Notary Public.
(Official Capacity.)

Com. expires Jan. 16, 1913.
(Seal of Executing Officer)

30

EXHIBIT "I".

UNITED STATES INTERNAL REVENUE.

Additional Assessment
July 1912 List
P. 1 L. 8,
Fletcher
Apr. 16 '12
6/22/12
F. B.

RETURN OF ANNUAL NET INCOME.

(Section 38, Act of Congress approved August 5, 1909)

INSURANCE COMPANIES.

RETURN OF NET INCOME Received during the Year Ending December 31, 1911, by INSURANCE COMPANY OF NORTH AMERICA, a corporation, the principal place of business of which is located at (Street and No.) 232 Walnut Street, City or Town of Philadelphia, in the State of Pennsylvania.

1. Total amount of paid-up capital stock outstanding at close of year		$4,000,000.00
2. Total amount of bonded and other indebtedness outstanding at close of year		$1,253,701.33
3. Gross Income (see Note A)		$9,911,450.94
		9,940,994.47
DEDUCTIONS.		
4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation EXCLUSIVE OF INTEREST PAYMENTS. (See Note B)	$3,223,244.53	3,166,528.19
5. (a) Total amount of losses sustained January 1 to December 31 not compensated by insurance or otherwise	$5,185,530.32	3,413.33
31 (b) Total amount of depreciation January 1 to December 31	$10,124.49	x x
(c) Total amount other than dividends paid within the year on policy and annuity contracts		$5,118,502.53
(d) Total amount of net addition required by law to be made within the year to reserve fund	$270,316.88	270,316.88

6. Total amount of interest paid January 1 to December 31 on an amount of bonded and other indebtedness not exceeding the amount of paid-up capital stock outstanding at the close of the year	$ None	x x
7. (a) Total taxes paid January 1 to December 31 imposed under authority of the United States or any State or Territory thereof	$192, 872. 72	244, 756. 63
(b) Foreign taxes paid	$ None	104, 989. 50
		8, 908, 507. 06
8. Amount received by way of dividends upon stock of other corporations, joint stock-companies, associations, and insurance companies subject to this tax	$104, 109. 50	
TOTAL DEDUCTIONS (see Note B)		88, 986, 198. 44
		$1, 032, 487. 41
9. NET INCOME		$925, 252. 50
10. Specific deduction from net income allowed by law		5, 000. 00
		1, 027, 487. 41
32 11. Amount on which tax at 1 per centum is to be calculated for assessment		920, 252. 50
Additional income		$109, 234. 91
" tax		1, 072. 35

F. B.

State of Pennsylvania, County of Philadelphia, to wit:

Eugene L. Ellison, President, and T. Houard Wright, Treasurer of the Insurance Company of North America, corporation, whose return of annual net income is set forth above, being severally duly sworn, each for himself, deposes and says that the foregoing report and the several items therein set forth are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct in each and every particular; that the amount of gross income therein set forth is the full amount of gross income, without any deduction whatsoever, received from all sources by the said corporation during the year stated, and that the net income therein set forth is the full amount by which to measure the tax at 1 per centum for assessment.

(Signed) Eugene L. Ellison
President.

(Signed) T. Houard Wright,
Treasurer.

SWORN AND SUBSCRIBED to before me this 26th day of February, 1912.

Thos. A. MacDonald,
Notary Public.
(Official Capacity.)

Com. expires Jan. 16, 1913.
(Seal of Officer taking affidavit)

33 # AFFIDAVIT OF DEFENSE.

Filed Feby. 25, 1914.

UNITED STATES OF AMERICA,
EASTERN DISTRICT OF PENNSYLVANIA, } ss.

William McCoach, having been duly sworn according to law deposes and says that he is the defendant in the above entitled cause and was during all the times mentioned in the amended Statement of Claim filed therein Collector of Internal Revenue, for the First Collection District of Pennsylvania, and that he has a lawful, just and full defense to the whole of the amount claimed by the plaintiff of the following nature and character, to wit:

1. Deponent admits the averments contained in paragraph 1 of plaintiff's amended statement.

2. Deponent admits that on or about or prior to August 15, 1912, the United States Commissioner of Internal Revenue, under authority of the Act of Congress of August 9, 1909, assessed against the plaintiff as an insurance company engaged in business in Pennsylvania an additional special excise tax amounting to $8875.91 upon annual net income for the year 1910, and an additional special excise tax amounting to $1072.35 upon annual net income for the year 1911.

3. Deponent admits the facts as averred in paragraph 3 of plaintiff's amended statement.

4. Deponent admits the facts as averred in paragraph 4 of plaintiff's amended statement.

5. Deponent admits the facts as averred in paragraph 5 of plaintiff's amended statement.

34 6. Deponent denies that the taxes paid by the plaintiff to the defendant, William McCoach, and for which the present suit has been brought were excessive or unjustly or illegally assessed against the plaintiff by the Commissioner of Internal Revenue, or were illegally or wrongfully collected from the plaintiff by the defendant, William McCoach, as Collector, to the extent of $1600.53 for the year 1910, and $1216.38 for the year 1911, or to any extent whatever.

Deponent avers that the said taxes were justly and legally assessed and legally and rightfully collected, for the reasons hereinafter set forth.

7. Deponent denies that the assessment for the year 1910 included

Tax assessed upon net addition required by law to be made within the year to reserve funds in the sum of..... $151,750.00

Deponent admits that the assessment for the year 1910 included

Tax assessed on accrued but unpaid interest on bonds not received by the company during the year for which the tax was assessed..... $8,303.41.

Deponent denies that the said item was improperly and illegally, and without warrant in law, included by the said Commissioner of Internal Revenue in the amount upon which the said assessment for the year 1910 was made.

8. Deponent denies that the assessment for the year 1911 included

Tax assessed upon net addition required by law to be made within the year to reserve funds in the sum of..... $113,000.00

Deponent admits that the assessment for the year 1911 included

35 Tax assessed on accrued but unpaid interest on bonds not received by the company during the year for which the tax was assessed..... $8,638.83.

Deponent denies that the said item was improperly and illegally, and without warrant in law, included by the said Commissioner of Internal Revenue in the amount upon which the said assessment for the year 1911 was made.

9. Deponent denies that the plaintiff was illegally taxed upon net additions required by law to be made to reserve funds for losses in 1910, $1517.50; in 1911, $1130.00.

(a) Deponent has no knowledge of the figures set forth in (a) of paragraph 9 of plaintiff's amended statement, alleged as appearing under the head of "Liabilities" in the annual reports of plaintiff to the Insurance Commissioner of Pennsylvania for the years 1909, 1910, and 1911, and, if the same are material to plaintiff's claim, deponent prays that the facts stated may be proved.

(b) and (c). Deponent has no knowledge of the facts set forth in (b) and (c) of paragraph 9 of plaintiff's amended statement of claim, and prays that if the said facts are material to plaintiff's claim they may be duly proved.

(d) 1. As to the allegations set forth in (d) of paragraph 9 of plaintiff's amended statement, deponent avers that plaintiff, in its original return of annual net income received during the year ending December 31, 1910, stated as one of the deductions to which it was entitled under 5(a) the total amount of its losses sustained from January 1 to December 31, not compensated by insurance or otherwise as $4,795,221.24, and in the same return stated as nothing under 5(c) the total amount other than dividends paid within the year on policy and annuity contracts. The Commissioner of Internal Revenue in amending the said return transferred a

36 part of the amount stated in 5(a) by the plaintiff, to wit: $4,651,913.91 to 5(c), making the total amount other than dividends paid within the year on policy and annuity contracts, $4,651,913.91.

2. Deponent admits that the Commissioner of Internal Revenue refused to allow as a deduction the sum of $151,750.00, which had been included by the plaintiff as part of its losses for the year 1910 under item 5(a) of the return.

3. Deponent admits that by making certain adjustments the Commissioner of Internal Revenue reduced the amount of deduction

claimed by the plaintiff under item 5(a) of its original return from $4,795,221.24
to 4,651,913.91
allowed by the Commissioner as a deduction of item 5(c) of the amended return.

(e) Deponent admits that as the result of the action of the Commissioner in disallowing such deduction of $151,750, plaintiff was required to pay and paid under protest an additional tax of $1,517.50.

(f) Deponent neither admits nor denies that plaintiff, in making up its return to the Commissioner of Internal Revenue, deducted from the net amount of unpaid losses for 1910, as shown by report to the Insurance Department of Pennsylvania for that year $1,099,500 ..... $1,099,500.00
the amount of salvage claims for that year 70,500.00

$1,029,000.00

before it subtracted therefrom the net amount of unpaid losses and claims for 1909, as shown by the report to the Insurance Department of Pennsylvania for a year 877,250.00

$151,750.00.

37 in order to arrive at the increase in unpaid losses and claims for 1910 over 1909, and demands proof of the same, in so far as it may be material to this action.

(g) Deponent neither admits nor denies that plaintiff took the amount of unpaid losses and claims, as shown by the 1910 report to the Insurance Department of Pennsylvania $1,099,500.00
and subtracted therefrom the amount of unpaid losses and claims as shown by the 1909 report to the Insurance Department of Pennsylvania 877,250.00

and averred in its claim for refund that it had therefore been illegally assessed upon $222,250.00
whereas, the illegal assessment was in fact upon the sum of $151,750, as above set forth, and demands proof of the same in so far as it may be material to the present action.

(h) Deponent admits that the amount of claim for refund for 1910, filed with the Commissioner of Internal Revenue, was in the sum of $2,305.53, whereas, the present amount of such claim is $1600.53.

(i) Deponent admits that in plaintiff's original return to the Commissioner of Internal Revenue for 1911 it made a deduction of $5,185,530.32 under item 5 (a) thereof. Deponent neither admits nor denies that the sum referred to in (i) of plaintiff's amended statement of claim was arrived at as averred therein, and demands proof of the same in so far as the same may be material to the present action.

(j) 1. As to the allegations set forth in (j) of plaintiff's statement, deponent avers that plaintiff, in its original return of annual net income received during the year ending December 31, 1911, stated as one of the deductions to which it was entitled under 5 (a) the total amount of its losses sustained from January 1, to December 31, not compensated by insurance or otherwise as $5,185,-
38 530.32, and in the same return stated as nothing under 5 (c) the total amount other than dividends paid within the year on policy and annuity contracts. The Commissioner of Internal Revenue in amending the said return transferred a part of the amount stated in 5 (a) by the plaintiff, to wit: $5,118,502.53 to 5 (c), making the total amount other than dividends paid within the year on policy and annuity contracts, $5,118,502.53.

2. Deponent admits that the Commissioner of Internal Revenue refused to allow as a deduction the sum of $113,000.00, which had been included by the plaintiff as part of its losses for the year 1911 under item 5 (a) of the return.

3. Deponent admits that by making certain adjustments the Commissioner of Internal Revenue reduced the amount of deduction claimed by the plaintiff under item 5 (a) of its original return

from	$5,185,530.32
to	5,118,502.53,

allowed by the Commissioner as a deduction of Item 5 (c) of the amended return.

(k) Deponent admits that as the result of the action of the Commissioner in disallowing such deduction of $113,000 plaintiff was required to pay and paid under protest an additional tax of $1130.00.

(l) Deponent neither admits nor denies that plaintiff, in making up its return to the Commissioner of Internal Revenue, deducted from the net amount of unpaid losses for 1911, as shown by report to the Insurance Department of Pennsylvania for

that year		$1,188,100.00
the amount of salvage claims for that year		46,100.00
		$1,142,000.00

39 and that it had deducted from net amount of unpaid losses for 1910 as shown by report to the Insurance Department of Pennsylvania

	$1,099,500.	
the amount of salvage claims for that year	70,500.	
		1,029,000.00
		$113,000.00,

and demands proof of the same in so far as it may be material to this action.

(n) Deponent has no knowledge of the facts set forth in (n) of paragraph 9 of plaintiff's amended statement, and prays that if the said facts are material to plaintiff's claim, they may be duly proved.

(o) Deponent denies that plaintiff was illegally assessed upon $113,000, and that the amount of such tax, to wit: $1,130, was illegally paid for 1911.

(p) Deponent admits that the present claim of the plaintiff upon this item for 1910 is reduced $705 and increased for 1911 $244, making a net reduction in the amount of plaintiff's total claim in this suit from the amount set forth in the claim for refund of $461.00.

(q) Deponent denies that the said sums of $151,750 for 1910 and $113,000 for 1911 were net additions required by law to be made within the respective years to reserve funds.

(r) Deponent admits that the Acts of Pennsylvania of June 23, 1885, (P. L. 134), section 1, and June 1, 1911, (P. L. 616), section 15, are as set forth in the amended statement of claim, but avers that they are immaterial to this cause of action.

(s) Deponent admits that the Insurance Commissioner of Pennsylvania did, in the years 1910 and 1911, require plaintiff and all other insurance companies doing business in Pennsylvania to file annual reports upon forms prepared by him, but denies that in such reports plaintiff, together with other companies, was required to carry as a liability for reserve the net estimated amount of unpaid losses and claims. Deponent neither admits nor denies that the Insurance Commissioner of Pennsylvania and fire insurance experts and actuaries generally consider unpaid losses and claims as outstanding policy obligations, and as properly represented in the reserve fund of the company, and demands proof of the same, if material to the present action. Deponent is advised and believes and therefore avers that such matters are immaterial in the present action.

10. Deponent neither admits nor denies that the annual report of the plaintiff to the Insurance Commissioners of Pennsylvania and other states for the years 1909, 1910 and 1911 under the head of "Non-Ledger Assets" contained the items set forth in paragraph 10 of the amended statement of claim. Deponent is advised and believes, and therefore avers, that such items, alleged to be contained in said annual reports, are immaterial to the present action, and, if deemed material demands proof of the same.

(a) Deponent admits that in plaintiff's original return to the Collector of Internal Revenue for the year 1910 it did not include in gross income any part of the interest which was due and accrued but unpaid upon December 31 of that year.

(b) Deponent admits that the Commissioner of Internal Revenue amended plaintiff's return for the year 1910 by adding to gross income the increase in the total amount of interest due and accrued for the year 1910 over the year 1909, to wit: $8,303.41, and assessed an additional tax for the year 1910 of $83.03.

(c) Deponent admits that in plaintiff's original return to the Collector of Internal Revenue for the year 1911 it did not include in gross income any part of the interest which was due and accrued but unpaid upon December 31 of that year.

(d) Deponent admits that the Commissioner of Internal
41 Revenue amended plaintiff's return for the year 1911 by adding to gross income the increase in the total amount of interest due and accrued for the year 1911 over the year 1910, to wit: $8,638.83, and assessed an additional tax against plaintiff for the year 1911 of $86.38.

12. Deponent denies that there existed no warrant in law for the assessment by the Commissioner of Internal Revenue of the said additional special excise taxes to the extent to which they are alleged in said amended statement of claim to be excessive, to wit: for the year 1910, $1600.53, and for the year 1911, $1216.38, and denies that there existed no warrant in law for demanding the said excessive taxes so assessed, but avers, on the contrary, that said additional special excise taxes were lawfully assessed, demanded and collected in accordance with the statutes and laws of the United States in such case made and provided.

W. McCoach.

Affirmed and subscribed to before me this 25th day of February, A. D. 1914.

Leo A. Lilly,
Deputy Clerk District Court United States
Eastern District of Pennsylvania.

PLEA.

Filed Feby. 26, 1914.

The defendant pleads non-assumpsit.

Francis Fisher Kane,
United States Attorney.

TO
The Clerk, U. S. District Court,
Eastern District of Pennsylvania.

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42 BILL OF EXCEPTIONS.

Filed Dec. 17, 1914.

Be it remembered, that in the said term of Court came the said plaintiff into the said Court, and impleaded the said defendant in a certain plea of assumpsit, &c., in which the said plaintiff declared

(prout narr.) and the said defendant pleaded (prout pleas). And thereupon issue was joined between them.

And afterwards, to wit, at a session of said Court, held at the County aforesaid before the Honorable Oliver B. Dickinson, Judge of the said Court, the 29th day of October, 1914, the aforesaid issue between the said parties came to be tried by the said Court without a jury, at which day came as well the said plaintiff as the said defendant by their respective attorneys; and upon the trial the counsel of the said plaintiff and the counsel for the said defendant entered into the following agreement and stipulation as to the facts in the said case and the said plaintiff to maintain and prove the said issue on its part offered the following evidence:

Before Hon. Oliver B. Dickinson, *J.*

Philadelphia, Thursday, October 29th, 1914.

Present:

B. Franklin Pepper, Esq., representing the plaintiff.

Francis Fisher Kane, Esq., United States Attorney, and

Edward S. Kremp, Esq., Assistant United States Attorney, representing the defendant.

Transcript of testimony, Rulings of the Court, and Exceptions.

43 The following stipulations were entered into between the attorneys representing the respective parties, and filed of record.

It is stipulated and agreed between the attorneys of record herein that, a jury being waived, the issues of fact in this case be tried and determined by the Court without the intervention of a jury, in accordance with Sections 649 and 700 of United States Revised Statutes.

Dated,

B. Franklin Pepper,
Attorney for Plaintiff.

Francis Fisher Kane.
U. S. District Attorney,
Attorney for Defendant.

AND NOW this 29th day of October, 1914, it is hereby agreed and stipulated by and between counsel for the above parties that the following facts are true and shall form part of the record of the trial of the above cause with the same force and effect as if proved by the testimony of witnesses. Both parties, however, shall have the right to offer at the trial of the case such other and additional testimony as to them may seem necessary.

1. The plaintiff is a corporation duly formed and existing under the laws of the Commonwealth of Pennsylvania, and was at all times hereafter mentioned, and still is engaged in the business of fire and marine insurance.

2. The defendant was at all times hereafter mentioned the Collector of Internal Revenue for the Eastern District of Pennsylvania.

3. On or about the 15th of August, 1912, the United States
44 Commissioner of Internal Revenue assessed against plaintiff as an insurance company engaged in business in Pennsylvania, an additional Special Excise Tax, under the Act of Congress of August 9, 1909, imposing a Special Excise Tax on corporations, amounting to $8,875.91 upon annual net income for the year 1910, and an additional Special Excise Tax amounting to $1,072.35 upon annual net income for the year 1911, alleged to be due from the plaintiff to the United States.

4. On August 22, 1912, plaintiff paid to the defendant the amount of the additional taxes assessed against it for the years 1910 and 1911 as aforesaid.

5. In this suit the plaintiff claims from the defendant the sum of $2,672.88 with interest thereon from August 22, 1912, which sum is that part of the additional Special Excise Tax assessed against plaintiff for the years 1910 and 1911 as aforesaid, which plaintiff contends was illegally assessed and collected. Plaintiff has taken all the steps required by law by way of paying the said taxes under protest and filing claims for refund of the same to entitle it to bring suit against the defendant for the recovery of the said sum.

6. Plaintiff claims that the additional Special Excise Tax assessed against it and paid for the year 1910, amounting to $8,875.91, was illegally assessed and collected to the extent of $1,600.53. The said sum of $1,600.53 is made up of two items: (1) The tax assessed upon the increase in the net amount of plaintiff's unpaid losses and claims for the year 1910 over the year 1909, $151,750, one per cent. of which is $1,517.50, which plaintiff claims constituted a net addition required by law to be made within the year to reserve funds, and was therefore properly deducted from the gross amount of the income of plaintiff, and which defendant claims did not constitute a net addition required by law to be made within the year to reserve
45 funds, and was therefore not properly deductable from the gross income of the plaintiff; (2) The tax assessed upon the increase in the total amount of interest due and accrued, but not paid, on mortgages and bonds owned by plaintiff for the year 1910 over 1909, $8,303.41, one per cent. of which is $83.03. Plaintiff claims that this sum was not legally included in its gross income for 1910 and is therefore not subject to tax. Defendant included the said sum in the gross income of plaintiff for 1910, upon which the aforesaid additional tax was imposed and paid.

7. Plaintiff claims that the additional Special Excise Tax assessed against it and paid for the year 1911, amounting to $1,072.35, was also illegally assessed and collected. The said sum of $1,072.35 is made up of two items: (1) The tax assessed upon the increase in the net amount of plaintiff's unpaid losses and claims for the year 1911 over the year 1910, $113,000, one per cent. of which is $1,130, which plaintiff claims constituted a net addition required by law to

be made within the year to reserve funds, and was therefore properly deducted from the gross amount of the income of plaintiff, and which defendant claims did not constitute a net addition required by law to be made within the year to reserve funds, and was therefore not properly deductible from the gross income of plaintiff; (2) The tax assessed upon the increase in the total amount of interest due and accrued, but not paid, on mortgages and bonds owned by plaintiff for the year 1911 over 1910, $8,638.83, one per cent. of which is $86.38. Plaintiff claims that this sum was not legally included in its gross income for 1911 and is therefore not subject to tax. Defendant included the said sum in the gross income of plaintiff for 1911, upon which the aforesaid additional tax was imposed and paid.

The difference between the amount of the additional Special
46 Excise Tax for 1911 assessed against and paid by plaintiff, $1,072.35, and the aggregate of the aforesaid items claimed by plaintiff to be illegally assessed and collected for the year, $1,216.38, resulted from certain adjustments made by the Government in assessing the said additional Special Excise Tax for the year 1911, which are not here in dispute between the parties. The plaintiff's claim for 1911 is limited to $1,072.35.

8. The annual reports of plaintiff made to the Insurance Commissioner of Pennsylvania, for the years 1909, 1910 and 1911 are true and correct statements of the operations and financial condition of plaintiff for the respective years, and shall be admitted in evidence at the trial of this case. The said annual reports are in the forms adopted by the Insurance Commissioner of the State of Pennsylvania for the respective years, and plaintiff and all other insurance companies doing business in the State of Pennsylvania were required to make their annual reports to the Insurance Commissioner of Pennsylvania in the said forms.

It is further agreed by and between counsel for the above parties that this case shall be tried before the Court without a jury.

FRANCIS FISHER KANE,
United States District Attorney for Defendant.
B. FRANKLIN PEPPER,
Plaintiff's Attorney.

PLAINTIFF'S EVIDENCE.

THOMAS HOWARD WRIGHT, having been duly sworn, was examined and testified as follows:

47 By MR. PEPPER:

Q. What position do you hold in the Insurance Company of North America?

A. Secretary and Treasurer.

Q. How long have you held that position?

A. About six years.

Q. How long have you been connected with the Company?

A. 33 or 34 years.

Q. Do you have charge of the preparation of the Company's reports to the Insurance Department of Pennsylvania?

A. I do.

Q. Will you explain to the Court the general nature of the items which make up the net amount of unpaid losses and claims of the Company, as shown by the annual reports of the company to the Insurance Commissioner of Pennsylvania for the years 1910 and 1911?

A. That represents the aggregate of what we call reservations commonly in the office for the individual losses as they are reported to us and entered in our books.

Q. That means fire or marine losses, which have accrued but which have not yet been paid and settled? Is that right?

A. That is right.

Q. Turning your attention to the item appearing on page 4 of the reports for 1910 and 1911, under the head of "Non-Ledger Assets. Interest Due and Accrued," will you explain to the Court the factors which make up the items of interest due and accrued appearing in the reports of the company for the years 1910 and 1911?

A. That is the aggregate of various amounts arrived at by calculation, represented by so many months' interest on our various investments which will mature—that is, will reach the six
48 months date during the following year. For instance, if we have an investment the coupons on which come due in February, representing six months interest, we would say five-sixths of the total of those coupons on that particular investment was accrued on the 31st of December.

By THE COURT:

Q. But not yet payable?

A. Not yet payable, no, sir.

By MR. PEPPER:

Q. And not yet collected or received by the company?

A. It could not be. The coupon matures in the future.

By THE COURT:

Q. As I understand it, that is merely a bookkeeping expedient for the purpose of the statement of accounts, just as if the account was made up on the exact moment that the income became payable and was actually received? It merely translates it into that sort of a position, does it?

A. If it were collectible. If that proportion of interest were collectible, that would represent how much would be coming to us on the particular investment. Or if we should sell the investment we would get that from the purchaser as accrued interest.

By MR. KANE:

Q. In other words, this was not actually received?

A. Or receivable.

By Mr. Pepper:

Q. I show you this pamphlet marked, "An Act to Incorporate the Subscribers to the Insurance Company of North America," approved by the Governor of the Commonwealth of Pennsylvania April 14th, 1794, and I ask you whether that is a true copy of the charter of the Insurance Company of North America up to the year 1910?

49 A. Of course I have never compared that particular copy. I believe it to be. I have compared other copies doubtless identical with that.

Q. The Charter of the Insurance Company of North America was amended on February 2nd, 1910, was it not?

A. Yes, sir.

Q. I show you another pamphlet marked, "Charter and By-Laws of the Insurance Company of North America", and I ask you whether that pamphlet contains the amendments to the original Charter of the Insurance Company of North America?

A. Yes, sir.

Counsel for the plaintiff offers in evidence the pamphlet entitled, "An Act to Incorporate the Subscribers to the Insurance Company of North America", being the pamphlet identified by the witness, containing the Act of April 14th, 1794, incorporating the Insurance Company of North America.

Counsel for the plaintiff also offers in evidence the pamphlet entitled, "Charter and By-Laws of the Insurance Company of North America", being the pamphlet identified by the witness, containing the amended charter of the Insurance Company of North America, dated February 2nd, 1910.

(Pamphlets marked, "Plaintiff's Exhibit A and B, 10-29-1914, C. F. P.", respectively.)

(No cross-examination.)

Mr. Kane: The Government moves to strike out that answer of the witness which had reference to what the practice of the company was with regard to putting aside certain funds which were characterized by the witness as part of its reserve to meet the net increase in unpaid losses and claims, on the ground that the practice of the company is not relevant evidence in this case.

50 The Court: The motion may now be made, and it will be passed upon together with the other questions that may arise in the case.

(Exception noted for defendant by direction of the Court.)

Samuel W. McCulloch, having been duly sworn, was examined and testified as follows:

Counsel for the Government requests counsel for the plaintiff to state what he proposes to prove by this witness.

Mr. Pepper: I offer to prove by this witness, the Deputy Insurance Commissioner of the Commonwealth of Pennsylvania, first, that the construction placed by the Insurance Department of Pennsylvania on the law of Pennsylvania required all fire and marine

insurance companies doing business within the Commonwealth of Pennsylvania to report and to maintain a reserve sufficient to meet the outstanding unpaid losses and claims of and against the company; and, second, I offer to prove by this witness that he is an expert in the technicalities and terminology of insurance, and that the reserve funds of an insurance company, as that term is generally understood, are sufficient funds to meet all of the insurance or policy obligations of the company.

MR. KANE: That is objected to as irrelevant.

THE COURT: The objection is overruled, and an exception granted to the United States, with leave, however, to move to strike out the testimony as irrelevant evidence, that motion to be considered together with the other questions which may arise in the case. The Court understands the real purpose of the offer now made is to inform the Court how much of this reserve the Insurance
51 Department of the State of Pennsylvania requires this company to maintain under their executive construction of the Act of Assembly.

(Exception noted for defendant by direction of the Court.)

By MR. PEPPER:

Q. How long have you been connected with the Insurance Department of Pennsylvania?

A. Since 1883.

Q. What position have you held in that Department?

A. First as clerk; afterwards as Deputy for two years, and as Insurance Commissioner, and I am at the present time Deputy.

Q. You have been the First Deputy in the Department for many years, excepting for two years, during which time you were the Insurance Commissioner?

A. I have been Deputy since 1894, except two years when I was the Insurance Commissioner.

Q. Your department has supervision over all corporations in Pennsylvania engaged in the business of insurance, does it not?

A. Yes.

Q. Do you have a hand in the preparation of the forms upon which corporations doing business in Pennsylvania shall make reports to your Department?

A. Yes, sir.

Q. Do you prepare them?

A. The blanks are prepared by a committee of the Insurance Commissioners, of which there are perhaps a dozen different departments represented, and I happen to be on that committee.

Q. That is, you mean the Insurance Commissioners of the different States?

A. Of different States, yes.

Q. Having in view your experience in the business of insur-
52 ance would you state to the Court what you understand to be the generally accepted and established meaning of reserve funds of an insurance corporation?

Mr. Kane: I desire it noted that the Government objects to this testimony, on the ground that it has not been shown sufficiently that the witness is an expert; and, secondly, that the question of expert testimony which is opened up now by this question is not of value in this case. It is immaterial what the expert's opinion is. What his opinion is as to reserve funds of an insurance company is irrelevant in this case, it being a question after all of what the Acts of Assembly of the State of Pennsylvania require. The Government is not objecting to the competency of the witness to so testify, but to the relevancy of expert testimony on that subject, and therefore the admissibility of any testimony he may give.

The Court: The objection is overruled, and an exception noted for the United States, with leave granted to move to strike out any testimony given as an expert judgment, that motion to be heard and decided along with the other questions that may arise in the case.

(Exception noted for defendant by direction of the Court.)

(Question repeated.)

A. First, the amount that should be set aside for the losses that occurred and had not been paid or determined; and, second, the amount that is to be returned to policy holders or used as re-insurance on policies that have not matured.

By Mr. Pepper:

Q. This second item that you refer to is what is commonly known as the re-insurance reserve, is it not?

A. Re-insurance reserve, unearned premium fund, in a fire insurance company.

53 Q. And the two items that you have referred to cover all the policy obligations of an insurance company, do they not?

A. All the policy obligations.

By The Court:

Q. As I understand it, here is a company that has an outstanding policy. There is a financial liability involved in that. Now, if that policy is issued to me and a sufficient fund is provided so that I can cancel that policy and re-insure my risk in some other company, practically that answers to that liability in one phase of it?

A. Yes, sir. That is the amount that you are entitled to receive in return, if you want it.

Q. If that is done, if I cancel that policy and re-insure in some other company, presumptively just as good, then I am just where I was?

A. Yes, sir.

Q. The policy is cancelled and then the company is relieved of all liability?

A. Yes, sir; the company is relieved of all liability.

Q. That wipes it out?

A. Yes, sir.

Q. On the other hand, the company might go to some other company, presumably and theoretically solvent, and say to them "Re-

lieve us of all this risk", and re-insure its own risks in that other company?

A. Yes.

Q. Now, theoretically that wipes out the obligation, because while there may be a loss under that policy the re-insuring company would make good the loss, and therefore it is balanced on both sides of the ledger? That is the idea?

A. That is the idea exactly; yes, sir.

By Mr. Pepper:

54 Q. You are familiar with the forms upon which the Insurance Company of North America made reports to your department for the years 1909 and 1910 and 1911, are you not?

A. Yes, sir.

Q. Are those forms the forms required by the Insurance Commissioner for use by all Insurance Companies doing business in Pennsylvania for those years?

A. They are.

Q. Under the law of Pennsylvania, as construed by the Insurance Commissioner, what does your department require fire and marine insurance companies doing business in Pennsylvania to maintain as a reserve fund?

A. All outstanding unpaid losses at the close of the year, and their unearned premiums; the outstanding losses being calculated, the exact amount where the loss has been adjusted and where the loss had been reported but not fully adjusted, the amount that will be sufficient to meet that claim when it is adjusted.

Q. The form of reports that you require from the Insurance Company of North America, and other similar companies, calls for information under the head of "Liabilities", first, in regard to the net amount of unpaid losses and claims, and, second, in regard to the total unearned premiums of the company. For what purpose do you exact that information from insurance companies reporting to your department?

A. To satisfy ourselves that the company is reserving sufficient money to enable it to meet its obligations and remain solvent.

Cross-examination.

By Mr. Kane:

Q. What you have been giving us are items which are required, are they not, by the Commissioner in the annual statement submitted by insurance companies, so as to show the financial condition of the company? That is it, as I understand it, is it not?

55 A. Yes, sir.

Q. In other words, in the printed forms which are issued by the department, and which have to be filled up, after the statement of the capital stock, the income and disbursements comes statements of assets and liabilities?

A. Yes, sir.

Q. And of course, upon the statement of assets and liabilities, perhaps more than any other, the solvency of the company is found?

A. It is determined; yes, sir.

Q. And, of course, the amount of gross losses adjusted and unpaid, the gross claims for losses in process of adjustment, the gross claims for losses resisted, they are all items in these statements, are they not?

A. Yes, sir.

Q. Those amounts are itemized?

A. Yes, sir.

Q. And there is also a provision for the deduction of reinsurance due and accrued, and after that a statement of the net amount of unpaid losses and claims?

A. Yes, sir.

Q. That is true, is it not?

A. That is true.

Q. And that net amount of unpaid losses and claims is the biggest liability of an insurance company at the time, I presume?

A. Next to the unearned premiums.

Q. Yes; next to the unearned premiums, of course. Of course, it would not be, in the nature of things, the concern being still a living company.

A. Or else the company would be insolvent.

Q. Precisely. That amount is treated as a liability by your department, and represents the amount which the company would have to pay for losses, substantially, the net amount of losses and claims not yet paid, as carried on its books?

A. Yes, sir.

56 Q. Under "Liabilities" there are other items, which, of course, must in the same way be treated as liabilities, are there not? I notice in the report of 1910 of the company, Item 21, "Commissions, Brokerage and other charges due or to become to Agents and Brokers," and it is down as $80,000. That in the same way is a charge which the company in 1910 would have to meet?

A. Yes. If the policy is not cancelled.

Q. It is contingent, I suppose?

A. It is contingent, you see, on the payment of the premium.

Q. This item, I notice, is to cover commissions and brokerage which have not already been charged off in Item 5 of disbursements. That is a charge that the company would have to meet, and would in the same way have to be taken into account as liabilities?

A. Yes, sir. You see, we allow the company to take credit in assets for agents' balances, and to offset the charge against that amount the commissions that have not been paid on those premiums that are in the hands of agents.

Q. Then, I see Item 22, "Return Premiums, none; Re-insurance Premiums $22,576.75". What is that item? What do we under-

stand by "Return Premiums, none; Re-insurance Premiums, $22,576.75"?

A. "Re-insurance Premiums" is the amount of premiums that the company owes the re-insuring company. They have not fully settled up their account with the re-insuring company, and that balance remains unpaid.

Q. In other words, Item 22, "Return Premiums; Re-insurance Premiums," is another liability, another item of liability?

A. Yes, sir; another liability. You will find on the asset side of it, "Re-insurance claims on losses paid, $35,678.24". Now, instead of deducting the $22,000 from that, we make a credit and a charge both, to show both items.

57 Q. Now, I notice here in your form, Item 20, "State, County and Municipal Taxes due or accrued." There happened in 1910 to be none, but that is an item of liability, is it not?

A. Yes. Well, it is an item that we have only put in that statement in the last two or three years. The taxes are to be paid sometime next year.

Q. But I suppose there are insurance companies in which you follow that item up pretty closely, small insurance companies, where the tax has not been paid?

A. Each state, of course, does, yes?

Q. And you would, too, in good practice, follow that up?

A. Yes, sir.

Q. In other words, that is an item necessary for the Insurance Commissioner as well as those other items in order to determine the solvency of the company, is it not?

A. Yes, sir.

Q. When we come to item No. 12 on this statement, "Total Unearned Premiums as computed above," you are then coming to what is required by the Act of Assembly as the reserve fund, are you not?

A. Yes, sir. The law designates just exactly how that shall be calculated.

Q. And it is a somewhat artificial, I mean a technical, thing? For instance, the law requires fifty percentum, does it not, of the premiums on the risks that are to expire before the end of the year, at least under the new Act?

A. Yes, sir.

Q. So that there you enter that amount of total unearned premiums computed as above in the items that come above, and in this case that item amounts to $6,379,416.23, because of the statute, don't you?

A. Yes.

Q. To make it a little clearer, on the next page of this
58 printed form—the forms are a little different, is a recapitulation of fire risks and premiums. Page 6 I refer you to. That is a recapitulation in accordance with law, is it not?

A. Yes.

Q. Or a recapitulation, in accordance with law, is it not, of the total unearned premiums?

A. Yes, sir.

Q. That is so, is it not?

A. Of course, after one year the percentages are rather arbitrary, taken by the departments as the best calculation of pro rata that they could make.

Q. The statute requires the pro rata?

A. The statute says pro rata, yes.

Q. So that you are acting, of course, under authority of the statute, and not under any discretion of your department?

A. Yes; sure.

Q. Of course, the figuring had to be done under it, but the statutes gives you the rule, and you follow it?

A. Yes. Of course, on this we do not follow it exact, because if we did we would have to take it month by month. Instead of that we take it and just average it for the year and calculate it in that way.

Q. That is one of the practical difficulties of accounting, is it not?

A. It is a practical difficulty.

Q. It might be an endless job?

A. Of course, to follow it closely we would have to take it month by month and calculate it throughout.

By THE COURT:

Q. But it is after all the department's finding of what the pro rata figures are?

A. Yes, sir.

By Mr. KANE:

Q. And the act, of course, does not say that you must do it month by month any more than week by week?

59 A. No.

Q. The Act just simply says pro rata?

A. Yes, sir; pro rata.

Q. And so you are following the Act when you require the companies to state it in that manner?

A. Yes, sir.

Q. The point I am getting at is this, that that is an arbitrary thing fixed by the Act of Assembly, no doubt for very good reasons, and not fixed in any way by your discretion in the matter?

A. That is right.

Q. And you include that item in the form of return because of the statute that exists?

A. Yes, sir.

Q. You do not include these other things as liabilities, that we have mentioned, because of the statute, do you?

A. Not of any specific statute.

Q. Because they are not the reserve required by law?

A. No.

Q. That is the difference, is it not?

A. The general liabilities of the company.

Q. And you would not consider a company as in good condition unless its statement of assets and liabilities took care of these particular items? That is so, is it not?

A. Yes, sir.

Q. And that is after all true, is it not, what you have just answered, as regards the net amount of unpaid losses and claims? You would not pass a company, would you, that had not in its statement given you a satisfactory statement—that is, itemized according to the form—of the net amount of claims there?

A. No.

Q. Of course you would not, because a company might be insolvent if it did not have enough money to meet it?

60 A. Yes.

Q. And there you are acting on what is plainly good business?

A. Not exactly there, because you take the Act of 1911, and it says that "the Insurance Commissioner, after having charged the unearned premium reserved and the reserve for losses, as defined above." Now, it does not define specifically how you are going to calculate the outstanding losses of a fire insurance company, because they are easily ascertainable, but it does say how you shall calculate the losses of other classes of insurance companies that are not so easily determinable. But it goes on to say that after calculating the unearned premium reserved and reserve for unpaid losses, and other liabilities, and having found the company's capital impaired, you shall do so and so. Now, while it does not specifically say how you shall calculate the losses of a fire insurance company, it applies to all insurance companies. It does not apply to just those casualty companies. Then, coming down a little later, to a later law, there is a specific provision as to how you shall calculate the reserve, as the law says, "the reserve for unpaid losses of companies doing a liability business."

Q. What you are referring to is Section 8?

A. Yes, sir; Section 8.

Q. As to casualty companies?

A. Yes.

Q. That provides, does it not, that the Insurance Commissioner, in calculating the reserve against unpaid losses—

A. Yes; reserve against unpaid losses.

Q. And that is what we are talking about, casualty companies?

A. Yes.

Q. "He shall, in calculating the reserve against unpaid losses of casualty companies, other than losses under liability policies,

61 set down by careful estimate in each case the loss likely to be incurred against every claim presented, or that may be presented in pursuance of notice from the insured of the occurrence of an event that may result in a loss." He shall set that down?

A. Yes.

Q. That has reference to casualty companies, has it not?

A. Yes. Casualty companies are specifically mentioned there, yes. Then, go on a little further.

Q. "And the sum of the items so estimated shall be the total amount of reserve".

A. Yes.

Q. "Except, in credit insurance, fifty per centum of the premiums on all credit policies expiring in the months of October, November, and December of the current year, less the amount of losses paid on such policies, shall, in addition thereto, be charged in the loss reserve."

A. Yes.

Q. That is Section 8, is it not?

A. Yes, sir; that is it.

Q. And that refers to casualty companies, does it not?

A. Yes.

Q. That does not, of course, apply—the words of the Act do not apply to fire and marine insurance companies, or life insurance companies either?

A. No. Not that particular section of the Act, no. But as you go on the Act says, "After having calculated these various items, every insurance company." Now, it don't apply to just the companies doing mercantile lines of business, or casualty lines of business, but, of course, we have got to calculate the unpaid claims of every insurance company. There are specific methods of calculating the unpaid claims of certain classes of insurance companies, where it is not easily determinable. But where you come to a fire and marine insurance company, where it is easy to determine,
62 we calculate the unpaid claims of the company. The law does not specifically say how we shall do it. I do not take it, though, that it does not mean that the company does not have to reserve anything for unpaid claims, because going on with that section it says that "if any company does not have the reserve for unpaid claims, as calculated above," and so forth, that the Commissioner shall proceed.

Q. Aren't we talking really of two different things? One a reserve required by law, and the other a statement of liabilities? Aren't we speaking of two different things there?

A. Well, I do not think so. I think the reserve for unpaid losses is just as much a requirement of the law as a reserve for unearned premiums.

Q. Can you show me where it is said that insurance companies shall hold as a reserve fund a sum or securities in a sum sufficient to meet unpaid losses? Do you catch my thought? There is a distinction, isn't there? To make it perfectly plain—I want to get your opinion about it. Are you not referring to a matter of liabilities rather than the reserve required by law, in insurance companies? In other words, does not the law say that a reserve fund shall be set

aside, and define it in the case of fire and marine and inland insurance companies?

A. Yes.

Q. Then, does it not afterwards say that a certain reserve fund shall be set aside in the case of casualty companies? Isn't that so?

A. Yes.

Mr. Pepper: I do not think you are correctly stating the law.

By Mr. Pepper:

Q. I do not understand that there is any provision in the Act that there shall be set aside any fund? All the Act does is to provide a method of calculating reserves?

63 A. Yes.

By Mr. Kane:

Q. The effect of it is the same, because, of course, unless the reserve fund was mentioned in this return you would not pass it, of course?

A. No.

Q. You would not pass the return?

A. No. I was just going to say, the law does not specifically say that a separate fund must be set aside for unearned premiums, but that the company shall have the amount on hand to cover those unearned premiums. If it does not have, it is insolvent. In the same way, if it does not have sufficient money on hand to pay its outstanding claims, it is insolvent.

Q. But in the one case there is the specific provision of the legislature, is there not, that a reserve fund shall be a certain character?

A. As to how it shall be calculated, yes; but it does not specifically say how you shall calculate the outstanding unpaid losses of fire companies. But it does say how we shall calculate the unpaid losses of any other class of companies. There is the only difference. But I do not take it that as far as the law is concerned it requires that the unearned premium fund shall be treated any differently than the unpaid loss fund.

Q. How is it with regard to life insurance? Do you regard the amount set apart to meet unpaid losses and claims as part of the reserve fund required by law?

Mr. Pepper: I object to that, as irrelevant.

A. It is the reserve for unpaid losses, but the reserve in a life insurance company is an entirely different matter, because it is an arbitrary amount based on a table of mortality.

By Mr. Kane:

Q. A table of mortality, as required?

A. Yes.

64 Q. It is an entirely different basis?

A. Yes.

Q. Not to wander off into that, I want to ask you: Is it not after all a question of definition of what you define the law to be? The

question which you are answering is what is your definition of the reserve fund, is it not—do you understand—rather than the statutory definition?

A. Well, no; I do not think so.

Q. Can you show me in the statute, where, in regard to fire insurance companies, the net amount of unpaid losses and claims is included in the reserve fund?

A. Taking Section 9, "Having charged as a liability the reinsurance and loss reserves."

Q. Where is that?

A. Section 9. "Having charged as a liability the reinsurance and loss reserves, as above defined for insurance companies of this commonwealth other than life."

Q. That throws you back to sections 7 and 8 of the law?

A. Yes. Sure.

Q. Section 7 defines what the reserve shall be in fire insurance companies?

A. In fire and casualty insurance companies.

Q. And Section 8 refers to casualty companies?

A. Yes, sir.

Q. So that you are no further at all.

A. While the Act does not specifically state how you are to calculate the outstanding unpaid losses of fire insurance companies, nevertheless it requires, in Section 9, that the reserve shall be charged against the company for unpaid losses, because this section, Section 9, applies to all companies except life insurance companies.

Q. After all his Honor will have the Act before him and he
65 will apply Section 9, as well as Sections 7 and 8, but the Act does not anywhere say, in defining the reserve funds required by law, in the case of fire insurance companies, that the net amount of unpaid losses and claims shall be included, does it?

A. Yes. I think it does.

Q. It does not include it there, does it?

A. I think it does, only it does not specifically say how we are going to calculate it.

Q. Of course, how you are going to calculate it is not the question before us, is it?

A. No.

Q. That is not the question at all before us. The question before us here in this case is, of course, whether you have included in that item reserve funds. Will you please tell me, is there anywhere else in the Act except in Section 9—is there any other part of the Act to which you can refer me?

A. Well, you take the Act of 1911 for the incorporation of fire insurance companies.

Q. This is the Act of 1911 we are reading.

A. There are half a dozen Acts of 1911. There were a series of Acts for the entire regulation of insurance companies.

Q. I wish you would point out to me the statute, if there is any other statute.

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A. In Section 19. This is an Act for the incorporation of fire and marine insurance companies.

Q. Section 19?

A. Yes, sir. "No such insurance company, heretofore or hereafter organized, shall make any dividend on its capital except from the profits arising from its business; and there shall be charged, as a liability, the capital of the company, all unpaid losses or other claims, all liabilities for unearned premiums."

Q. That still has reference to how the liabilities shall be stated, does it not?

A. Yes.

66 Q. It has no reference, has it, to the matter of the reserve required by law? If there is, I wish you would point it out. This is Section 19 of the Act of June 1st, 1911, Pamphlet Laws 559?

A. Yes.

Q. And it provides: "No such insurance company, heretofore or hereafter organized, shall make any dividend on its capital except from the profits arising from its business; and there shall be charged, as a liability, the capital of the company, all unpaid losses or other claims, all liabilities for unearned premiums. And also all sums due the company on bonds and mortgages, bonds, stocks, and book account, of which no part of the principal or the interest thereon has been paid during the last calendar year, and for which the foreclosure or suit has not been commenced for collection, or which after judgment obtained thereon shall have remained more than two years unsatisfied, and on which interest shall not have been paid, and all interest due and remaining unpaid, and all other debts or obligations of the company." I have read Section 19. That has reference to liabilities?

A. Yes.

Q. And how they shall be set forth?

A. Yes.

Q. There is nothing in there, is there, about reserve funds required by law?

A. No.

Q. Can you think of any other place in the law which will justify you in including the net amount of unpaid losses and claims in the reserve fund required by law?

A. No. I do not recall any other section.

Q. What have you in mind when you say that the Insurance Commissioner requires an inclusion of this item of unpaid losses and claims in the reserve fund required by law? Have you in mind any written ruling of your department?

A. No. I do not recall that we have issued any specific ruling on that.

67 Q. Have you any rules and regulations of the Insurance Commissioner?

A. No; there are not.

Q. Does the Insurance Commissioner from time to time give opinions?

A. Oh, yes.

Q. Those are on particular cases?

A. On particular cases.

Q. They are on particular cases, as I remember them?

A. Yes.

Q. They are reported in the Legal Intelligencer, I think, sometimes?

A. Yes, sir.

Q. They are as to particular cases, and you haven't in mind any particular case at all?

A. No, sir.

Q. Have you in mind any correspondence between the particular company here, the Insurance Company of North America, and your department?

A. No.

Q. As to what is the reserve fund required by law.

A. No. There was no such opinion given.

Q. If you require this as part of the reserve fund, this item of unpaid losses and claims, why don't you so state it in the form of return that you send out to the insurance companies?

A. We do not in our statement show the unearned premiums as a reserve fund.

Q. You do not make any statement anywhere as to it?

A. No. We charge up in our statement the amount of the unearned premiums fund of the company. We do not specifically state it as a reserve fund. But it is the amount that the company must have on hand to take care of that liability, just the same as the item above is the amount that the company must have on hand to take care of its outstanding loss liability.

68 Q. In other words, there is nothing on the return or in the form of return prepared by your department at all to show what particular items are a compliance with the law as to reserve funds required by law?

A. No.

Q. Nothing at all?

A. No.

Q. And you, therefore, have to go to the statute or to what your individual opinion would be on the subject? Isn't that so?

A. Yes.

Q. In other words, there is nothing in the practice of the department except your own individual ideas as to it, which would throw this particular item of unpaid losses and claims into the category of reserve funds required by Act of Assembly? Is that so? Do you understand what I mean?

A. I think I do.

Q. There is nothing in the practice of the department, is there, at all except your own individual ideas, or the ideas of your department, as to what is the reserve fund required by law?

A. As to fire insurance companies—

Q. As to fire insurance companies.

A. I would have to say, I guess, yes, because there is no specific mention of it, as to the way it is to be calculated. Now, the law as to other classes of insurance specifically designates as a reserve fund liability for unpaid losses.

Q. But as to fire insurance companies—we have already threshed through that, and we know just what the definition is, subject to some construction which you put upon section nine of the Act? I do not want to miss anything that you have said.

A. Yes.

Q. Subject to that, you have got to harp back to the law, have you not, to find it out? You cannot find it out from the re-
69 turn here and you cannot find it out from the practice of your department, because the practice of your department is simply what you conceive to be the law? That is true, is it not?

A. Yes.

Q. In other words, you cannot point me to any particular case in which the insurance department has ruled that the net amount of unpaid losses and claims is part of the reserve fund required by law?

A. I think that Section 9 is clear enough, that the company must maintain a reserve fund of an amount sufficient to meet those outstanding claims, and while it does not specifically designate the unpaid losses of a fire insurance company, as to how they shall be calculated, it does require that they shall have that reserve or be declared insolvent.

Q. No, pardon me. That is your theory of it, but that does not say——

A. We proceed against them to make good.

Q. Of course, this company has this large surplus?

A. Yes, of course.

Q. To get back to my question. There is no departmental practice really on the subject, is there?

A. No.

Q. It is simply your idea of the law to be, for which, of course, I have great respect.

Re-direct-examination.

By Mr. Pepper:

Q. It is true, of course, that all the items appearing under the head of "Liabilities" in the return of insurance companies are liabilities of the company? That is correct, is it not?

A. Oh, yes.

Q. What distinction do you make between the liabilities listed as net amount of unpaid losses and claims, and total unearned premiums, being the first two items in the case of "Liabilities"?

70 A. The first two items are the liabilities to policy holders. That is, the company is in the business of insurance, taking care of its clients, and we treat the losses and unearned premiums as the principal liability of the company, because that is its business, to take care of the policy holder.

Q. The purpose of a reserve fund is what? To take care of policy holders, is it not?

A. Yes. It is to return to its policy holders what belongs to them. I was going to make this suggestion: You are required—when a loss is reported the statement is made of about how much damage has been done. That you take as the measure of your unpaid losses until the loss is adjusted. It may be a trifle more or it may be a little less, but the company reserves for each loss that is reported the estimated amount of the face of the report.

By Mr. Kane:

Q. When you say the company reserves, you do not know anything about that, do you? You simply know that in the statement of losses and claims unpaid the figures are so and so? You do not mean to tell me that you know there has been an actual reserve?

A. No.

Q. Reserved by the Company?

A. No. I do not say anything of the sort. I only want to say that the company is supposed to report in there the amount of all the losses that they have adjusted and have not yet paid, and the amount that has been reported to them as probably required to be paid.

By Mr. Pepper:

Q. The report of this company for the year 1909, which is in evidence, sets forth that under Item 6 of "Liabilities" on page 5, "Net amount of Unpaid Losses and Claims, $877,250." Your department, as I understand it, accepted that report as a true statement of the amount of unpaid losses and claims of the company for that year?

71 A. Yes.

Q. The same thing is true, is it not, of the report of the company for 1910, showing "Net amount of Unpaid Losses and Claims, $1,099,500," and of the report of the company for 1911 of $1,188,100?

A. Yes.

Q. When we speak of a reserve being maintained or set aside, is it not true that there is no physical or actual setting aside of money or other assets by an insurance company? That is correct, is it not?

A. That is correct, yes.

Q. A reserve is merely a theory, is it not, for calculating the insurance liability of a company with a view to determining its solvency or insolvency? Isn't that correct?

A. That is correct, exactly. When we examine a company, one of the first things we do is to look in and see whether the company has reported and estimated their unpaid losses correctly, neither under estimated nor over estimated.

By THE COURT:

Q. As I understand, the reports which this company made to your department, with the amount of additions to reserve which those reports showed, that was the amount of additions which your department required them to carry? Is that correct?

A. Yes, sir.

By MR. KANE:

Q. To make it perfectly plain, the net amount of unpaid losses and claims which the company returns is a liability, is it not?

A. It is a liability, yes, sir.

Q. And that is essential, necessary to be stated, of course?

A. Yes, sir.

Q. Just as the "Total Unearned Premiums as computed above", in your form, must be stated?

72 A. Yes, sir.

Q. And the "Total Unearned Premiums as computed above" is a statement of what Section 7 of the Act of 1911, with regard to the year 1911, required as the—

A. Unearned Premium Reserve.

Q. No. Not using those words, but as the reserve fund required by law? That is what Section 7 of the Act required as the reserve fund required by law?

A. No. As the unearned premium fund of the company.

Q. It is called the unearned premiums?

A. Yes.

By THE COURT:

Q. Isn't that merely an item in the reserve that the company is required to carry?

A. It is.

By MR. KANE:

Q. That is your theory? Your theory of the other item is that the company is required to carry it as a reserve fund? The other item is "Net Amount of Unpaid Losses and Claims"?

A. Yes, sir.

Q. That is your theory of the law?

A. That is my theory.

Q. "Net Amount of Unpaid Losses and Claims" represents a present indebtedness of the company, does it not? You take the gross amount of losses adjusted and paid and not yet due, and then

you take the gross claims for losses in process of adjustment, or in suspense, and so forth, and then the gross amount of losses resisted, and you total them, and then you deduct the re-insurance accrued, and you get the net amount of unpaid losses and claims, and that is part of the indebtedness of the company, is it not?

A. Yes.

Q. Do you catch me perfectly?

73 A. I catch you, yes.

Q. That is part of the existing indebtedness of the company, and therefore properly chargeable as a liability. Now, this other matter is not, strictly speaking, part of the indebtedness of the company, is it?

A. Oh, yes.

Q. The next item, to wit, "Total Unearned Premium", is a liability, strictly speaking, rather than an indebtedness, is it not?

A. Yes, sir.

Q. The first item "Net Amount of Unpaid Losses and Claims," there has been no actual payment out of the treasury of the company, yet to meet it, of course?

A. No.

Q. Do you catch my thought there?

A. Yes.

Q. If you were then ascertaining the net income of the company, from year to year, and there was an increase in the one year of the net amount of unpaid losses and claims over the net amount of unpaid losses and claims for the year previous, it would not mean that the company had paid out any money, would it?

A. No.

Q. It would only mean that its indebtedness had increased?

A. Increased that much.

Q. Do you catch my thought?

A. Yes.

Q. Therefore, if you were estimating net income on the theory of cash paid out and the payments of cash paid out during the year, the payments of cash being deducted in estimating what had come in from the net income which the company had gotten during the year, you could not take account of the increase in the net amount of unpaid losses, could you? On a cash basis you could not take account of that, could you?

A. No; not on a cash basis.

74 Q. And apparently the only way of taking account then of the first item—for the purposes of estimating income on a cash basis and not on a revenue basis, the only way of taking account of that, checking it up, would be to take it up under an item which the law allows, would it not, of course—which the law allows?

A. Yes; which the law allows.

By Mr. Pepper:

Q. I do not know whether you meant to attach any significance to the distinction between the words "liability" and "indebtedness"

in answering Mr. Kane's question. The "Unearned Premiums" is a liability, is it not?

A. Yes.

Q. It is no more an indebtedness than "Unpaid Losses" reserve, is it?

A. No.

By Mr. Kane:

Q. Is it a liability? There is no question about that?

A. Oh, yes; it is a liability.

Mr. Kane: The Government admits that, but that is not an indebtedness.

Mr. Pepper: Which is not? Which are you talking about?

By Mr. Kane:

Q. The "Total Unearned Premiums as computed above" is not an indebtedness? It is a liability?

A. It is a liability against the company. It is an indebtedness of the company to re-insure unless the policy holder cancelled the policy. Then it becomes an indebtedness at once.

By Mr. Pepper:

Q. But these unpaid losses and claims are not an indebtedness, are they? The company does not owe anybody any particular sum of money and owe a duty to pay it now, does it?

75 A. No.

By Mr. Kane:

Q. It is a fact, is it not, as you have already testified, that there is nothing between this company, or any other company, in the way of a form or in the way of correspondence showing what the reserve required by law is, other than shown by this statement? Isn't that so?

A. That is correct.

Q. You take the view, I understand, or your department takes the view—and, of course, I have the utmost respect for you, and for your own personal opinion—that the "Net Amount of Unpaid Losses and Claims" which is named here as a liability, is included in the net reserve required by law?

A. Yes, sir.

Mr. Kane: And the Government takes the view, to make it perfectly plain to your honor, that that is not included in the net reserve required by law, and the net reserve required by law, the only item in it, is the "Total Unearned Premiums as computed above".

By Mr. Kane:

Q. Now, to make it perfectly plain—because we will have to talk about this, and you have been examined as an expert—I want to know whether there is not a great distinction between the first item and the second to be made, in that the one is an indebtedness, and also put in the statement as a liability, and the other, the second, is not an indebtedness of the company, but rather a liability?

A. Yes. I think you are correct in that. The first is a liability.

By Mr. Pepper:

Q. What is the first? What do you mean by the first?

76 Mr. Kane: The "Net Amount of Unpaid Losses and Claims."

A. The "Net Amount of Unpaid Losses and Claims" is a liability, and it is an indebtedness that must be met sometime in the future. The "Total Unearned Premiums" is a liability, and it may or may not become an indebtedness.

By Mr. Kane:

Q. In other words, it is really an imaginary fund, we will say, reserved to meet what? To meet the case, is it not, of unexpired risks?

A. Yes.

Q. It is the amount figured out under the rule given us by the legislature of Pennsylvania to correspond with the case of the unexpired risks which the company is carrying? Isn't that it?

A. That is it.

Q. It is a liability of the company, and you cannot call it properly an indebtedness at the time?

A. No. At any specific time.

Q. Not to take too long, but passing to the other point that I made a little while ago, in order that it may be clear, the first item, which is "Net Amount of Unpaid Losses and Claims," representing an indebtedness, does not in any way mean a cash payment by the company during the year, the net increase of which from year to year would not mean that there had been an increase in the cash paid out?

A. No.

Q. It would not be reflected in any way upon the cash books of the company, of course?

A. No.

Q. So that in figuring the income, the net income—that is, on a cash basis—the company could not take the net increase from year to year in the amounts of unpaid losses and claims into account, could it?

77 By Mr. Pepper:

Q. Do you make any such calculation as that? The Government does not impose a tax on your income?

A. No. We make our calculation on an income basis.

Mr. Pepper: If your Honor please, that is purely a hypothetical question that Mr. Kane is asking him.

Mr. Kane: It is a hypothetical question.

By Mr. Kane:

Q. It does not represent any cash payment? That first item, to wit, "Net Amount of Unpaid Losses and Claims", does not represent any cash paid out by the company, does it?

Mr. PEPPER: I object to that.

THE COURT: The objection is overruled, and an exception noted for the plaintiff, with leave to the plaintiff to strike out the answer, that motion to be passed upon with the other questions in the case.

(Exception noted for plaintiff by direction of the court.)

A. It does not.

By Mr. KANE:

Q. And in any one year the net increase of the losses and claims over the losses and claims of the last year does not represent any outgoing cash of the company in the year?

A. No.

Q. In other words, I suppose it would come in as part of the capital account and not the income account?

A. Yes.

Q. The second item, the item which we speak of as the second item, to wit, as it is worded here, "Total Unearned Premiums
78 as computed above," the total unearned premiums of the company, which we have described as an item of liability rather than of indebtedness, does not in itself represent any cash paid out, does it, at all?

A. No. It represents cash received.

Q. It represents really cash received? It is the cost of re-insurance of the unexpired risks, as we get to it through these statutory means of ascertaining it, is it not, really?

A. You talk of the excess as representing cash paid out. It represents an increase in the premium income.

Q. Leaving out the excess in that question, the amount of the unearned premiums as figured out in this technical and artificial, although no doubt wise, way, required by law, that does not in any way cover a cash payment by the company?

A. No.

Q. It only covers, does it not, being the unearned premiums—it only covers what it would cost to reinsure?

A. Yes. Or to cancel the insured's policy.

Q. So that if the unthinkable should happen and the Insurance Company of North America should go out of business, that would be the sum which it would have to have in order to re-insure the risk which it is carrying?

A. Yes, sir.

MARSHALL G. GARRIGUES, having been duly sworn, was examined and testified as follows:

By Mr. PEPPER:

Q. What is your occupation?

A. Secretary and Treasurer of the Fire Association of Philadelphia.

Q. How long have you been in the fire insurance business?

A. 45 years.

79 Q. In your capacity as treasurer of the Association do you have to do with the making of reports of your company? Are you familiar with the requirements of the Insurance Department of Pennsylvania?

MR. KANE: I would like to object here to the question as being irrelevant.

THE COURT: The objection is overruled, and an exception noted for the defendant, with leave to the defendant to strike out the testimony, that motion to be passed upon with the other questions of the case.

(Exception noted for defendant by direction of the court.)

By MR. PEPPER:

Q. Will you state what, in your opinion, you consider as properly represented in the reserve fund of a fire and marine insurance company?

A. I would consider, in view of both the amount reserved for unpaid losses and also the amount for returned premiums, that they are both matters relating directly to the underwriting business. It is the contract between the company and the assured.

Q. In the insurance business what is properly represented in the reserve fund of a fire and marine insurance company?

A. The understanding of all the companies—I, of course, have not taken any particular conference with the various men of the different companies as to their own opinion or how they do it, but it is agreed to according to the same schedule that is furnished us by the different departments.

By THE COURT:

Q. I understand all these various means and practices have a meaning that is understood by the people in the business. It may not convey the same idea to people that are not in the business. That
80 is why Mr. Pepper asks you that question, that in the insurance world, when a reserve fund is spoken of what does that reserve fund include with respect—you need not go into all the items, but what we are interested in—with respect to the unpaid losses and an insurance risk which is still outstanding, or, in other words, the unearned premium feature.

A. Both items, the amount reserved for unpaid losses and the amount reserved for unearned premiums.

By MR. PEPPER:

Q. You were going to give your answer.

A. Yes. Supplementing my own personal reason in the matter, it is a part of the contract between the company and the assured, and whatever amount may be due the assured for returned premium under an expired policy and what is also due to him as a loss. A few moments ago Mr. Kane spoke about a loss made up by an unexpired term.

By THE COURT:

Q. Let me ask you there: In the Pennsylvania statutory form of insurance, and, so far as I know, the universal custom in the insurance business anyhow, even if there is no statutory form of contract, there is a provision giving a mutual right either for the insured or the insurer to cancel that risk, is there not?

A. Yes, sir.

Q. An insured having the right to cancel the risk and understanding that he does cancel it the insurance company owes him the unearned premium?

A. Yes, sir.

Q. Ordinarily in fixing those amounts there is this distinction made, that the insured cancels the policy and the unearned premium is calculated on one basis, and if the insurance company cancels the policy then the unearned premium is calculated on another basis?

A. Yes, sir.

81 Q. One known as pro rata and the other short rate?

A. That is right.

Q. When you are calculating these unearned premiums, on which basis in that respect do you calculate them?

A. I just want to state in this connection, in regard to our re-insurance, the schedule for our re-insurance premiums, the unearned premiums, that I have nothing to do with. That is always furnished me by another department, and I have not gone into the matter to answer that question.

THE COURT. The Insurance Commissioner calculates it apparently on a pro rata basis.

MR. PEPPER. Probably Mr. McCulloch can answer that.

MR. MCCULLOCH. Yes.

Cross-examination.

By MR. KANE:

Q. You are the Treasurer of the Fire Association, I understand?

A. Yes, sir.

Q. And you are familiar with the annual statements which go to the Commissioner from your company?

A. Yes, sir.

Q. You also have paid a corporation excise tax to the Government?

A. Oh, yes. I always make that up.

Q. In the return to the Collector that item has appeared in your return, has it not?

A. Yes.

Q. From year to year?

A. Yes.

Q. Covering the net increase in the reserve funds as required by law?

82 A. Yes. That is right.

Q. It has, has it not?

A. Oh, yes.

Q. You never have included in your return to the Government, have you, the net amount of unpaid losses and claims as part of the reserve fund required by law?

A. Yes. For three years we did that, both in 1910 and 1909 and 1911, and when Mr. McCoach's office came around there it was stated to me that the ruling of the Government was that we should only allow the actual cash paid losses from this capital fund. That was their decision, and I did that. I made my return along with the 1909, 1910 and 1911, on the first return, measured by the same idea, as I stated awhile ago, that the unpaid losses were part of the reserve.

Q. You claimed that as incurred losses, did you not?

A. Yes, sir. I made the return as incurred losses instead of paid losses.

Q. And the Government objected to your putting in that item anything except the losses actually paid? Is that true?

A. That was the idea, yes, sir.

Q. In other words, you had a right, of course, in taking your income for the year to deduct—in ascertaining your net income you had a right to deduct the amounts actually paid by you for losses already occurred?

A. Yes.

Q. That is true, is it not?

A. Yes.

Q. You did not put that in as part of the reserve fund required by law, of course?

A. But in making my return as incurred losses, I did.

Q. Yes; you put it in as cash payments. In other words, you did not attempt to do what the Insurance Company of North

83 America thinks it has the right to do? In other words, to put in the amount of your unpaid losses and claims, or the increase in unpaid losses and claims as part of the reserve fund required by law?

A. I understood that they made a similar return to ours; that their return was identical with ours.

Q. I think they did.

A. That is my impression. I would not want to say exactly.

Q. Do you catch my point entirely? You understand what I am talking about, do you? In your case you made a return of the actual losses and claims that you paid altogether during the year, incurred and paid?

A. Incurred, yes. I won't say paid. Incurred.

Q. If you made it of the unpaid losses and claims, the Government did not accept that as part of the reserve funds required by law?

A. No. The Government did not accept that. I took it on my understanding of the matter. That the incurred losses was the fact

that it was to be taken for, and make our allowance on the incurred losses of the year.

Q. You would agree, would you not, in the position which Mr. McCulloch took when on the stand that the unpaid losses and claims of the company are an indebtedness of the company in the sense that unearned premiums are not?

A. No. I differ with him.

Q. You would say that one is as much an indebtedness as the other?

A. Certainly.

Q. How do you arrive at that conclusion? Why is there not an element of contingency, a very big element of contingency in the one case?

THE COURT: I do not think you correctly quoted Mr. McCulloch. What he had in mind evidently was the distinction between a loss which had fallen upon the insurer, and therefore the obligation of the company to make good that loss already in a sense matured, and the outstanding liability under a contract of insurance when no loss has yet occurred. Of course, from his point of view it would be implied, at least from what he stated, and I think it was expressed, that as far as the obligation to return the unearned premiums is concerned, it is just as much an indebtedness in the sense of an obligation as any other indebtedness is. But the liability of the company to make good losses that have not occurred as a contingent liability in a sense, in which case, in ordinary language, you could not speak of that as an actual indebtedness.

84

MR. KANE: That is the important point. It is not the whole point, but it is an important point to a clear understanding of the case.

THE WITNESS: Mr. Kane raised the question about one being an indebtedness. Now, there is a portion of the unpaid losses which is just as necessary, as far as the amount goes—a good part of it, in fact—a large percentage of it—that is unsettled and undetermined, and really not as much determined as what the unearned premiums are. In other words, they are all unadjusted losses, which you figure on a certain amount.

By MR. KANE:

Q. Now, when you come to the unearned premiums, there is the same element of uncertainty as there is, if you can imagine the company going on from year to year and actually earning those premiums and then fires occurring—you would have the same element, would you not, in the end, because there would be the claims yet to be adjusted? In other words, there would be the great element of contingency in the one case as there would be in the other?

A. I cannot see the difference. When you make the separation of indebtedness and liability, I claim—I am not like Mr. McCulloch—they are identical in my mind. I should say so, and I think it would be considered so in the insurance world.

85

THE COURT: I think you and Mr. McCulloch agree on that, but you recognize a distinction between an obligation which the company assumed on a loss that had actually occurred, and, for instance, one class of them actually adjusted and the liability existing upon an outstanding policy where no loss had occurred, and nobody can say whether there is going to be a loss or not.

THE WITNESS: Yes.

THE COURT: You would not consider those two things as identical, would you?

THE WITNESS: Your Honor, that was just as far as the liability. I was taking into consideration the cash returned and not the liability for losses.

THE COURT: That is the very distinction he made. There is a liability in each case, but there is a difference in the character of the liability, which might very well be expressed by calling one an indebtedness and the other a liability?

THE WITNESS: Yes; but to my mind they mean identically the same thing, when I made that answer.

PLAINTIFF CLOSES.

THE DEFENDANT OFFERED NO EVIDENCE.

TESTIMONY CLOSED.

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and on the seventh day of December the said Court handed down an opinion entering judgment for the said plaintiff for $192.73 with costs of suit, but refusing to enter judgment for the said plaintiff for the sum of $2847.74.

86 And thereupon, the counsel for the said Insurance Company of North America, plaintiff, did then and there except to the aforesaid opinion of the said Court, and inasmuch as the said opinion, so excepted to, does not appear upon the Record:

The said counsel for the said Insurance Company of North America, plaintiff, did then and there tender this Bill of Exceptions to the opinion of the said Court, and requested the seal of the Judge aforesaid should be put to the same, according to the form of the statute in such case made and provided. And thereupon the aforesaid Judge at the request of the said counsel for the plaintiff did put his seal to this Bill of Exceptions, pursuant to the aforesaid statute in such case made and provided, this day of December, 1914.

OLIVER B. DICKINSON. (L. S.)
(L. S.)

Approved:
FRANCIS FISHER KANE,
United States Attorney.

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OPINION.

Filed Dec. 7, 1914.

TRIAL BY THE COURT WITHOUT A JURY.

DISCUSSION.

DICKINSON, *J.*

This case was tried before the Court without the intervention of a jury, under the provisions of Sections 649 and 700 Revised Statutes. The evidential facts are not in controversy, and the case partakes almost of the nature of a case stated. An excise tax under the provisions of the Act of Congress of August 5th, 1909 was assessed
87 against and paid by the plaintiff. The payment, so far as affects the questions involved, was accompanied by the usual formalities which give the plaintiff the right to recover in this form of action the amount claimed, if the tax was illegally exacted. All this is conceded by the defendant, and the necessary facts and conclusions of law are found to this end, and there is no need to incorporate them in formal special findings. The question, therefore, resolves itself into one of the liability of the plaintiff to the payment of the tax. The only disputable question is further really narrowed to one of the proper application of the latter part of the second of the five classes of deductions allowed by the Act of Congress to be made from the "gross income" of the plaintiff in order to determine the taxable "net income". The real question is embraced in the phrase "the net addition, if any, required by law to be made to reserve funds" of insurance companies.

There is, however, another question which may be disposed of before discussing that which we have thus characterized as the real question. This first question is this: The Collector included in the "gross income" of the company and thereby taxed as income certain sums of accrued but as yet unpaid interest on investments held by the plaintiff. This accrued interest was represented by unmatured interest coupons payable in the future. The income to which this dispute applies was not strictly of this character, but this is fairly representative of all of it and admittedly presents the point to be ruled. No discussion of it is called for, because since the tax was imposed the very question raised has been decided in favor of the plaintiff for us.

Mutual Benefit Life Ins. Co., vs. Herold,
198 Fed., 199
Ibid, 201 Fed., 918
Ibid, 231 U. S., 755.

The plaintiff is therefore entitled to judgment for the tax thus improperly imposed.

IN CENTER

88 The remaining question is a difficult one to compress into a simple statement. It can most clearly be presented thus:

The plaintiff was incorporated by a special Act of Assembly of the Commonwealth of Pennsylvania, approved April 14th, 1794. It is subject to the general insurance laws of the State. These provide for the establishment of an Insurance Department, which is under the charge of an Insurance Commissioner, upon whom has been conferred drastic powers of control over all companies doing an insurance business in the State. Every such company is "required by law" to submit itself to the regulations of this Department under penalty of having all its business transactions in the State suspended. The main and real purpose is to make clear the solvency of the companies by making such returns of their financial condition as will show their capital to be unimpaired further than is tolerated by law. To this end they are required to return as liabilities all the obligations called for by such forms of returns as are prepared for the purpose by the Insurance Department. Among the obligations so required to be returned as liabilities is the net amount of the company's unpaid losses or claims against it and the amount of the premiums called for by its policies so far as they are then unearned. These sums are reserves. Every calling comes to have its own terminology. As part of this, the same word may come to have a special meaning in particular callings. This is true of the word "reserve", which it will be remembered is the word used in the Act of Congress. The policy obligations of an insurance company are unique in that they are contingent, being contracts of indemnity only. In a statement of the financial condition of a company, to treat these contingent obligations as an absolute liability, would be to doom every insurance company, no matter how strong financially, to technical insolvency. They are none the less obligations,
89 and in a very practical sense liabilities. The real question is to what extent? If no losses have been incurred, the company may reinsure or cancel its policies, and the amount of the unearned premiums therefore measures very fairly the money liability. Losses, however, may have been incurred on some policies. They may therefore be classified, and we have among these latter policies those under which no proofs of loss have been submitted; those under which proofs have been submitted; and those upon which losses have been adjusted as well as admitted and disputed claims. What may be termed the actual liability may thus be measured with substantial accuracy. The aggregate of these sums must be carried as a liability and thus becomes technically known as an "insurance reserve", and the moneys thus carried as "reserve funds". If the company carries any insurance against such policies, this is allowed to be deducted, and we have the "net amount of losses and claims" which together with the "reinsurance reserve" or unearned premiums constitutes the "insurance reserve" "required by law" to be maintained by the company. In the forms of returns as required to be made by this plaintiff for the years 1909, 1910 and 1911 all these

items are called for and set forth in detail and they constituted or rather were included as part of "the reserve required by law" to be maintained. For the several years they and the surplus of the plaintiff company were as follows:

	1909	reserve	$7,796,094.92
		surplus	2,577,235.60
		net	$5,218,859.32
	1910	reserve	$8,327,931.49
		surplus	3,712,333.93
		net	$4,615,597.56
90	1911	reserve	$8,908,377.36
		surplus	4,202,404.41
		net	$4,705,972.95

The real surplus of a corporation is, of course, the difference between the aggregate value of all its assets and the sum of all its liabilities, including capital stock. This difference may be called surplus, undivided profits, contingent fund, or by any other name. In a real and substantial sense, it is a reserve. Broadly speaking, it is not required to be maintained but may be paid out in dividends or otherwise distributed among the stockholders. Ordinarily, no part of it is embraced in the sum total of liabilities. When, however, something is added to the sum of liabilities which is not owing by the company, this addition then becomes a reserve. It is in this sense that moneys set aside to meet possible liabilities are "reserves", and if required by law to be thus carried, they are "additions required by law to be made to reserve funds".

Let us pause here to bring into the discussion the Act of Congress. It was clearly the purpose of Congress to impose this excise tax based upon the net income of corporations received during the year. To ascertain this, the gross income is taken, reduced only by certain specified deductions. The general purpose of the Act is to make the statement of income a statement of cash receipts and disbursements. Actual payment is made the test of deductions. It was recognized, however, that in certain instances the money might be as effectually withdrawn from available income as if actually paid away. The allowance of the deduction embraced in the phrase already quoted is one. This company did add to its reserve by including in its liabilities unpaid losses and claims and unearned premiums. The sums thus added have been stipulated and are found as stipu-
91 lated. The losses for 1911 in fact exceeded those of 1910 by $88,600., and the latter exceeded 1909 by $222,250. The question, therefore, is were these sums net additions required by law to be made to the reserve fund? If the company had been without

surplus, then the amount of losses must have been reserved for 1909 and for 1910, and as the latter exceeded the former by $222,250., that much additional would have been so required. As, however, the company in 1909 had a large surplus, and therefore a much larger reserve than was required by law, there was no requirement to make any "additions" to it in 1910. In other words, the company was not required to add this $222,250.00 to its reserve. It could have paid it out in dividends had it so decided and its entire capital have been left unimpaired with millions to spare. The same is true of 1911 when the company had a surplus of $4,000,000.00 and a contingent fund of $202,404.41. It is evident, therefore, there was no requirement of law to add $88,600.00 to the reserve the company already had. Moreover, under the law of Pennsylvania, the capital is not required to show clear and unimpaired above the sum of liabilities, including the items under discussion. There is a leeway of twenty per cent. allowed. What Congress had in mind was something more than a mere book-keeping fact. What the Act of Congress says is that when a company is financially so situated that a part of its yearly income is not available for corporate use but is required to be set aside and placed beyond the reach of the company as absolutely as if it had actually been paid away, then it may be deducted just as if it had been so paid but not otherwise. The stipulated sums of $151,750.00 for the year 1910 and $113,000.00 for the year 1911 are taxable and were properly not deducted from the gross incomes for those years respectively.

There is no need for special findings of fact. These general findings are sufficient.

The conclusions of law reached are as follows:

92 CONCLUSIONS OF LAW.

1. The income sum of $8303.41 on which an excise tax was assessed and collected for the year 1910 was not taxable as income.

2. The income sum of $8638.83 on which the tax was assessed and paid for the year 1911 was not taxable as income.

3. The sum of $151,750.00 was properly not deducted from the taxable income for the year 1910.

4. The sum of $113,000.00 was properly not deducted from taxable income for the year 1911.

5. The plaintiff is entitled to judgment for the sum of One Hundred and Ninety-two and Seventy-three Hundredths Dollars ($192.73), made up as follows:

1910 tax payment	$83.03
Interest from August 22d, 1912	11.43
1911 tax payment	86.58
Interest from August 22d, 1912	11.89
Amount of judgment	$192.73

together with costs of suit.

This judgment is accordingly entered in favor of the plaintiff and against defendant for One Hundred and Ninety-two and Seventy-three Hundredths Dollars ($192.73), with costs of suit.

ORDER FOR JUDGMENT.

Filed Dec. 22, 1914.

To the Clerk of the United States Court:

Enter judgment in accordance with the opinion of the Court filed December 7, 1914, for the plaintiff as follows:

Judgment $192.73

G. W. PEPPER,
Plaintiff's Attorney,
by JOSEPH S. CONWELL.

December 19, 1914.

93

JUDGMENT.

Before THOMPSON, *J.*

And now, to wit, this 22nd day of December, 1914, by order with praecipe filed, judgment is hereby entered in accordance with the opinion of the Court in the above entitled case in favor of the plaintiff and against the defendant in the sum of One hundred and ninety-two and 73/100 ($192.73).

BY THE COURT,

Attest:

LEO A. LILLY,
Deputy Clerk.

ASSIGNMENTS OF ERROR SUR WRIT OF ERROR OF INSURANCE COMPANY OF NORTH AMERICA.

Filed Dec. 22, 1914.

1. The learned Trial Judge erred in directing a judgment to be entered for the plaintiff in the sum of $192.73 instead of in the sum of $3,040.47.

2. The learned Trial Judge erred in reaching the following conclusion of law: "3. The sum of $151,750 was properly not deducted from the taxable income for the year 1910."

3. The learned Trial Judge erred in not holding that the said sum of $151,750 should have been deducted from the plaintiff's taxable income for the year 1910.

4. The learned Trial Judge erred in reaching the following conclusion of law: "4. The sum of $113,000 was properly not deducted from taxable income for the year 1911."

94 5. The learned Trial Judge erred in not holding that th sum of $113,000 should have been deducted from the plain tiff's taxable income for the year 1911.

G. W. PEPPER,
Plaintiff's Attorney.
per B. F. PEPPER.

PRAECIPE SUR TRANSCRIPT.

Filed Dec. 23, 1914.

To the Clerk of the United States District Court for the Easter District of Pennsylvania:

In making up the transcript of record in the above-entitled cas you are to include the following papers:

Docket Entries,
Writ of Error,
Amended Statement of Claim,
Affidavit of Defense,
Plea,
Bill of Exceptions,
Opinion,
Praecipe for Judgment—Judgment,
Assignments of Error,
Clerk's Certificate,

and no others.

G. W. PEPPER,
by JOSEPH S. CONWELL,
Attorney for Plaintiff-in-error.

95 UNITED STATES OF AMERICA, }
EASTERN DISTRICT OF PENNSYLVANIA, } *sct.*

I, WILLIAM W. CRAIG, Clerk of the District Court of the Unite States for the Eastern District of Pennsylvania, do hereby certif that the annexed and foregoing is a true and faithful copy of s much of the Pleas and Proceedings in the case of Insurance Com pany of North America vs. William McCoach, Collector of Interna Revenue, No. 2402 Dec. Term, 1912, as per praecipe filed, a copy o which is hereto annexed now remaining among the records of th said court in my office.

IN TESTIMONY WHEREOF, I have hereunto subscribed my nam and affixed the seal of the said District Court at Phila (SEAL) delphia, this 31st day of December in the year of ou Lord one thousand, nine hundred and fourteen and i the one hundred and thirty-ninth year of the Independence of th United States.

WILLIAM W. CRAIG,
Clerk District Court U. S.

96 IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

No. 1916. March Term, 1915.

INSURANCE CO. OF NORTH AMERICA, PLAINTIFF IN ERROR,
vs.
WM. MCCOACH, COLLECTOR. DEFENDANT IN ERROR.

And afterwards, to wit, on the nineteenth day of April, 1915, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Hon. Joseph Buffington, Hon. John B. McPherson and Hon. Victor B. Woolley, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the sixth day of July, 1915, come the parties aforesaid by their counsel aforesaid, and the Court now being fully advised in the premises, renders the following decision:

(*Opinion.*)

97 In the United States Circuit Court of Appeals for the Third Circuit.

INSURANCE COMPANY OF NORTH AMERICA, Plaintiff below	No. 1916.
vs.	March Term, 1915.
WILLIAM MCCOACH, Collector	

Error to the District Court of the United States for the Eastern District of Pennsylvania.

Before BUFFINGTON, MCPHERSON, and WOOLLEY, Circuit Judges.

MCPHERSON, Circuit Judge.

Under the Act of August 5, 1909, the government compelled the Insurance Company of North America to pay an excise tax with respect to its net income for the years 1910 and 1911. This suit is brought to recover a part of the tax, the company claiming that too much had been exacted. In the court below two items were in dispute, and, as the company obtained judgment for only one of them, this writ of error presents the question, whether judgment should have been entered for the other item also—a sum of $2503.47, with interest. The opinion of the district judge is reported in 218 Fed. at p. 905.

The trial was without a jury, and nearly all the facts were agreed upon, only three witnesses having been heard. The controversy arises in this way: The company, a Pennsylvania corporation chartered in 1794 by a special Act (P. L. 129), is now subject to the general insurance laws of the state. Its business is confined to fire and marine risks. As the Federal statute lays the tax with respect to net income, the question is immediately presented—How is net income

to be ascertained? The answer is found in #2, and we quote
98 so much of the section as is now important; " * * Such net income shall be ascertained by deducting from the gross amount of the income of such * * * insurance company * * all losses actually sustained, &c., * * * and in the case of insurance companies the sums other than dividends paid within the year on policy and annuity contracts, *and the net addition, if any, required by law to be made within the year to reserve funds.*" We italicize the words on which the decision turns.

1. The first matter to be noted is, that the deduction in question is such addition as may be "required by law." The parties agree that this phrase means the law of the particular state, for the federal government does not attempt to regulate the internal affairs of insurance companies. In this case, we have to do with the requirements of the Pennsylvania law, and especially with such as concern the reserve funds of fire and marine insurance companies. (The reserves required from companies doing other kinds of insurance are not involved in this controversy). Whatever sum therefore the law of the state required the Company to add to its reserve funds during each of the years in question is expressly declared by Congress to be a proper item of deduction from the company's gross income. For the moment, we defer the examination of the Pennsylvania law on this subject, in order to consider the ground on which the district court decided against the company. Briefly, the position taken by the learned judge is this—that, because the company had an ample surplus, much more than adequate to meet every addition to its reserve funds that was required by the state, it could not be allowed the deduction given by the federal statute. One of the additions required was the amount necessary to meet unpaid losses and claims, and the ground taken below seems in effect to be this; since the company had accumulated a surplus more than enough to meet these unpaid claims, it had lost its right to the deduction. We do not know whether the deduction would have been regarded as allowable, if the company had been barely able to provide for these liabilities, but in any event we cannot agree with the conclusion. Surplus is what remains after making provision
99 for all liabilities of every kind (leaving capital stock out of the present consideration); and, as we understand the situation before us, the surplus of the Insurance Company of North America is what remained after it had made provision for these losses by setting aside all that the Pennsylvania law required for that purpose. We are unable to see how the fact can be relevant, that (after thus providing once for these losses) the company still had in its treasury a large sum of money out of which it could pay them again, and several times over. In other words, we do not think the company's surplus has anything to do with the present dispute. Congress has in terms allowed the company to deduct from its gross income "the net addition, if any, required by law to be made within the year to reserve funds;" and, as we see the question for decision,

it is simply this—What net addition does the Pennsylvania law require to be made to the reserve funds of an insurance company doing a fire and marine business only?

2. In order to answer this question correctly, we must first ascertain what Congress meant by "reserve funds". Was the phrase used in a special sense, or does it include generally such funds as must be reserved to meet liabilities, whether they be contingent or already adjusted? In our opinion it bears the general meaning. If Congress intended to allow no other deduction on this account except what is technically known as "re-insurance reserve", or unearned premium, it is not easy to understand why that well-known term of art was not used. The plural form—reserve funds—seems also to indicate that Congress intended to include not only reinsurance reserve, but any other fund as well that a state might require the company to set aside for the purpose of meeting such a liability as unpaid losses and claims. This seems to be the natural and ordinary meaning of the words, and presumably therefore is the construction to be adopted.

What then does the Pennsylvania law require to be added to
100 the reserve funds of a fire and marine insurance company?

For more than 40 years the state has had a department of insurance, and a system of regulating the affairs of companies doing that kind of business, and from time to time it has passed statutes on this subject. On June 1, 1911, an Act was adopted codifying and superseding many of the previous enactments, and (altho this statute is later than 1910, one of the years now in question) we need not go behind it, since for present purposes it does not differ materially from the earlier Acts. The system is as follows: A department of insurance is established in charge of a commissioner, whose powers of control are varied and extensive. He is to see that all the laws of the state respecting insurance companies are faithfully executed. At his pleasure he may investigate and examine the affairs of any company with the utmost thoroughness. If it has failed to comply with the law, or if he shall find its assets insufficient, he may suspend its entire business, reporting the delinquent to the attorney-general for further action looking to its dissolution. He is to make an annual report to the legislature of the condition of all the companies doing business in the state. Every such company must file an annual statement, using the blank forms furnished by the commissioner, who may adopt any form he thinks "best adapted to elicit from them a true exhibit of their financial condition." Failure to make such a statement, or the making of a false statement, is severely punished.

The Act provides in section 4 the method of ascertaining the "reserve liability" of life insurance companies (with which we have no present concern), and then in sections 7, 8 and 9 turns to the subject of ascertaining the financial condition of other companies. These sections first take up reinsurance reserve, and provide that "in determining the liabilities upon its contracts of insurance of any insurance company other than life insurance, and the amount such company

shall hold as a reserve for reinsurance" the commissioner shall charge casualty insurance companies with a certain proportion of their premiums; and—

101 "For fire insurance companies he shall charge 50% of the premiums written in their policies upon all unexpired risks that have one year, or less than one year, to run, and a pro rata of all premiums on risks having more than one year to run; on perpetual policies he shall charge the deposit received, less a surrender charge if not exceeding 10% thereof. From (For) marine and inland risks he shall charge 50% of the premium written in the policy upon yearly risks, and the full amount of the premium written in the policy upon all other marine and inland risks not terminated."

Having thus dealt with reinsurance reserve, the statute goes on to unpaid losses, and provides that the commissioner "shall in calculating the reserve against unpaid losses" pursue a certain method with casualty companies (which does not need consideration now); and then, taking up other classes of companies, it declares in section 9 that after the commissioner has "charged as a liability the reinsurance and loss reserves as above defined for insurance companies of this commonwealth other than life, *and adding thereto all other debts and claims against the company*," he shall thus ascertain whether the capital of the company has been so impaired that the company should be required to make the impairment good, as a condition to the doing of further business.

Acting under the authority of the statutes that have been in force since 1873, the commissioner has required the plaintiff and similar companies to return each year, as an item among their liabilities, the net amount of unpaid losses and claims, whether such losses are actually adjusted, or are in process of adjustment, or are resisted; and in so doing he has followed what the department has always understood to be the command of the Pennsylvania law. It is true that in this particular the statutes have never been interpreted by the supreme court of the state, but we think it must be conceded, that (even if their meaning be considered doubtful) they are susceptible of the construction thus put upon them by the department that completely controls the subject. Moreover, as far as we know, the construction has never been contested, and it is clear that this form of report has been required by the department from the beginning. We have felt at liberty to examine the commissioner's

102 official reports for 1876, 1884, 1894, and 1904, (altho these were not in evidence) as well as the company's reports for 1910 and 1911, and we find this item of unpaid losses always charged as a liability. Being a liability, and so charged in the company's accounts, funds are necessarily "reserved" to meet it, altho of course they are not, and need not be, physically set aside for that purpose.

One of the witnesses has been connected with the department for more than 30 years, either as clerk or deputy or as the commissioner himself, and he testified to this construction and gave excellent reasons therefor. Another witness, a man of 45 years' experience,

testified that this was the general construction in the insurance business, and no evidence was offered to the contrary. Indeed, it is difficult to see how any other opinion could be entertained. After a loss has happened, the damage done thereby becomes an undoubted liability of the company, and (except now and then) will have to be met. In most cases all that remains to be done is to adjust the loss in order to ascertain the precise amount due, and usually this amount can be estimated in advance with sufficient accuracy to determine how much the company should set aside to make the damage good. Such unpaid losses are "claims against the company", and in our opinion the Pennsylvania law (while it may be somewhat lacking in precision of statement) required them to be added to the company's liabilities, and required funds to be reserved sufficient to meet them in full.

It is hardly necessary to cite authorities on the point that the uniform construction of a statute adopted by the highest administrative authorities is entitled to great respect; (U. S. v. Healey, 160 U. S. 141, U. S. v. Hermanos, 209 U. S. 339); and we should hesitate long before we differed from such a construction, even where we had more doubt concerning its correctness than we have in the
103 present instance.

The district judge entertained the same opinion concerning the meaning of "reserve funds" as we have just expressed, but was misled (as we think) by his views in reference to the surplus. We conclude that the company was entitled to the reduction in dispute, and the judgment must therefore be reversed with instruction to allow the claim.

Endorsed: No. 1916. Opinion of the Court by McPherson, J. Received and filed July 6, 1915. Saunders Lewis, Jr., Clerk.

104 (Insurance Company of North America *vs.* McCoach, Collector.)

(Third Judicial Circuit.)

Wooley, Circuit Judge, dissenting. I oppose the judgment to be entered in this case. While approving the judgment below, I do not concur in the reasoning upon which it was entered. With very great respect for the opinions both of the court below and of this court, I am constrained to differ with both; and being unable, in this peculiar situation, to indicate the grounds for my dissent merely by noting the same, I will state as briefly as may be, the matters that have controlled by judgment.

The Corporation Excise Tax Law (36 U. S. Stat. 112) imposes an annual tax upon the privilege of doing business in a corporate capacity, and bases its assessment upon the annual net income of a corporation. Net income is ascertained by deducting from the gross income sundry designated items, as ordinary and necessary expenses actually paid, losses actually sustained, and in the case of insurance

companies, "the net addition, if any, required by law to be made within the year to reserve funds." In permitting a deduction of an addition to the reserve funds of a corporation over its reserve funds of the previous year, and thereby exempting them from taxation, Congress recognized that in the case of insurance companies, certain funds are uniformly and necessarily reserved to meet liabilities, which, from the very nature of the business of insurance, are unknown and contingent; and in describing the reserve funds thus to be deducted, Congress made no attempt to define their nature or prescribe their amount, but in the absence of Federal law upon the subject, obviously contemplated and intended such funds as are required to be reserved by the laws of the states in which insurance companies do business. In doing this, Congress purposely made the provision so elastic that the Federal law might readily be administered in harmony with the laws of different states.

105 The controversy in this case, therefore, resolves itself into a question of what constitutes the "reserve funds," "required by law" of the State of Pennsylvania, or, stated with reference to the particular claim upon which this suit is founded,—does the law of Pennsylvania require fire insurance companies to maintain "reserve funds" to meet "unpaid losses and claims."

The plaintiff insurance company is a fire and marine insurance company, and for the purposes of this case, may be treated with respect to its business of fire insurance alone.

The law of Pennsylvania upon the subject of reserves for fire insurance companies, in so far as it affects the question in this action, is embraced in two statutes. The act of April 4, 1873, P. L. 20, provides for a "reinsurance reserve for unexpired fire risks," to be calculated upon certain percentages of premiums received, and makes no other provision for reserve funds. The Act of June 1, 1911, P. L. 607, requires the maintenance of precisely the same "reinsurance reserve for unexpired fire risks," calculated in the same way, and likewise makes no other provision for reserve funds. The statute, however, requires *casualty* insurance companies, in addition to such "reinsurance reserve," to maintain reserves to cover "unpaid losses," estimated upon claims presented.

The "reinsurance reserve," which is sometimes termed the "unearned premium reserve," indicating a reserve against either the contingency of loss, or protection by reinsurance, or the cancellation of a risk by the insured with a demand for the return of the unearned part of the premium, is by section 7 of the Act of 1911, required of *all* insurance companies other than life. This includes fire insurance companies. A reserve against "unpaid losses" is required by section 8 *only of casualty* insurance companies. This does not include fire insurance companies. Section 9 of the Act, however, contains this provision:

"Having charged as a liability the reinsurance and loss reserves *as above defined* for insurance companies of this Commonwealth

other than life, and adding thereto all other debts and
106 claims against the company, the Commissioner shall, in case he finds the capital of the company impaired 20 per cent., give notice to the company to make good the capital within sixty days."

The Deputy Commissioner of Insurance, speaking for the Department of Insurance of Pennsylvania, testified, and upon his testimony this court and the court below hold, that section 9, which defines as a "*liability*" the "*reinsurance and loss reserves*", makes the "reinsurance reserves" and the "loss reserves" *together* constitute the "reserve funds" of *fire* insurance companies, "required by law" of the State of Pennsylvania, the annual addition to which may, by authority of the Federal Act, be deducted from gross income, and escape Federal taxation.

I regret that for two reasons I cannot concur with this construction of the statute. The first reason is based upon the language of the statute, which in declaring the "reinsurance and loss reserves" to be a "liability", refers to them "as above defined." How are "reinsurance reserves" and "loss reserves" "above defined"? The "reinsurance reserve" is defined by section 7 of the Act and extends to *both* fire and casualty insurance companies. The "unpaid loss reserve" is defined by section 8 of the act, and relates *only* to casualty insurance companies. Therefore, in mentioning these two reserves by the general language of section 9, the act was cautious to maintain the distinction which theretofore was made between them by using the words "as above defined", and leaves the reserve required of fire insurance companies just as it is defined by Section 7.

As the statute by expression makes no provision for a reserve fund against "unpaid losses and claims" of *fire* insurance companies, a deduction of an addition thereto, cannot be allowed in ascertaining the net income of fire insurance corporations upon which to
107 base its corporation excise tax, unless, indeed, it is found, by construction, that the statute makes such provision. Upon this, I surmise, there is entire accord. Can the statute, therefore, be construed to require fire insurance companies to maintain reserve funds against "unpaid losses and claims"?

In considering the language to be construed, it is found that the part of the statute in which a reserve fund for *fire* insurance companies is required and defined, but one kind of reserve is denominated, namely, "a reserve for reinsurance". The statute is silent with respect to fire reserves for other purposes, but the statute, taken as a whole, is not silent with regard to its purpose. If its object had primarily been the requirement and establishment of insurance reserves, and acting under the two statutes for forty years, the Department of Insurance had required the maintenance of real reserves against unpaid losses and claims, the effect of a decision contrary to that practice resulting in its disestablishment, this might be an instance in which the meaning of a statute is to be determined

by its contemporaneous exposition. But the establishment and definition of insurance reserves do not, in my opinion, constitute the theory of the statute or its purpose, upon which its construction must be founded. The act contemplates something altogether different and altogether more comprehensive. What is its purpose?

Supervision of the business of insurance has everywhere become a function of State government. States have undertaken to protect their citizens from losses incident to the insolvency of insurance companies, and to this end, the State of Pennsylvania, by the Act of 1911, prescribes the methods by which the protective measures it assumes may be effectuated. While this act deals indirectly with reserve funds to meet contingent liabilities to be incurred by insurance risks of certain characters, it deals primarily with the *whole* assets and liabilities of such companies, and provides how such companies may be watched, their solvency determined, and their
108 continuance in business terminated, in order that the public may be protected. The object of this statute is to *ascertain* the solvency of insurance companies, rather than to prescribe the methods by which solvency may be maintained. In order to determine their solvency, insurance companies are required annually to report their total assets and liabilities. Their liabilities are of two kinds, known and unknown, or fixed and contingent. Against *all* liabilities of *both* kinds, the Department of Insurance is required to ascertain whether there exist assets sufficient to assure solvency. In a sense, assets so set off against all liabilities may represent assets reserved to meet all liabilities, but assets so employed do not constitute "reserves" as used in the nomenclature of the business or in the sense employed in either the Federal or the State statute. In fact, the State statute considers unexpired fire risks as a "liability", and provides a reserve to meet the same. This is the only fire reserve which the statute expressly requires. But the statute also considers *all other liabilities* of fire insurance companies, and insists that against their liabilities of all kinds, there shall be assets enough to maintain solvency. Section 9 of the act clearly discloses this purpose by providing that,

"Having charged as a *liability* the reinsurance and loss reserves as above defined, * * * *and adding thereto all other debts and claims* against the company, the Commissioner shall, in case *he finds the capital of the company impaired* twenty per cent., give notice to the company to make good the capital within sixty days."

Under this section of the statute, the Department of Insurance requires every insurance company to report *all* of its liabilities, contingent and fixed, those against which reserves are required by law to be maintained, and those against which reserves are not so required, sets off assets against all of them, and then ascertains whether the company's capital is impaired twenty per cent., and accordingly grants or withholds from it permission to continue business. Among the list of liabilities, fixed and contingent, off-set against
109 which, assets and capital must be shown intact in order to

disclose solvency, are these, as shown by a report of the plaintiff insurance company, in evidence:—

(1) "Unearned premiums" (against which the law expressly provides the unearned premium or *reinsurance reserve*)	$6,655,570
(2) "Unpaid losses and claims" (which include the item in dispute)	518,000
(3) "Estimated amount hereafter payable for Federal, State and other taxes", (which includes the very tax now in controversy)	90,000
(4) "Brokerage and other charges due or to become due to agents or brokers"	80,000
(5) "Contingent fund"	202,404

Each of these items represents liabilities incurred but not ascertained. Each represents *contingent* liabilities of one character or another. The contingent liability of "unearned premiums" is calculated in the way prescribed by law, for which a reserve fund is "required by law" to be charged as a liability. Against the other contingent liabilities, no reserve funds are expressly required by law, but the Department of Insurance demands that they be reported, and very properly requires that sufficient assets be maintained to meet them when ascertained, thereby to insure the solvency of the company. In this list of estimated contingent liabilities is the disputed liability of "Unpaid losses and claims." If an addition to assets retained to meet that liability may be deducted, in ascertaining net income for Federal taxation purposes, I do not see why additions to assets held against equally undetermined and contingent liabilities of "Federal, State and other taxes", "Brokerage and other charges, due or to become due" and "contingent fund", may not likewise be deducted. If the policy of the law and the practice of the Department, in requiring insurance companies to preserve sufficient assets to meet all liabilities, make and constitute such assets "reserve funds" within the meaning of the State statute and
110 within the contemplation of the Federal statutes, then in logic the whole volume of assets so preserved and in amount equal to the whole volume of liabilities, constitutes "reserve funds", and when additions are made to the several parts thereof, such additions may be deducted and escape Federal taxation. Surely, this cannot have been intended by one statute or contemplated by the other.

A careful reading of the Pennsylvania statute, supported somewhat by the testimony of the Deputy Insurance Commissioner, suggests that in the scheme of the statute, the principal reason for a reference to a "reinsurance reserve" for fire insurance companies, and a "reinsurance reserve" plus a fund reserved against "unpaid losses" for casualty companies, is to afford the Department of Insurance an authoritative method of *calculating* reserves against liabilities of such contingent characters. "All other debts and claims" which are included among liabilities contemplated by the

Act, may readily be calculated, and when the liabilities of the two classes are added together, they constitute the total liabilities against which the policy of the Pennsylvania law requires assets to be disclosed and capital unimpaired in order to insure solvency. (Section 9)

I am of opinion that the difficulty in this case arises out of a confusion in the use of the words "liabilities" and "reserves", and "assets" and "reserves". The statute of Pennsylvania defines the liabilities against which reserves in the technical sense shall be maintained, namely, "reinsurance" or "unearned premiums" in case a fire insurance company; "reinsurance" plus "unpaid losses", in casualty companies; and requires also that against all other liabilities, assets shall appear in order to show solvency. Liabilities of the latter class, until met and paid, cannot escape federal taxation by deducting them from the gross income of the corporation. Liabilities of the former class cannot escape taxation by deduction from gross income, unless against such liabilities a reserve fund is specifically required by law.

It has been urged that if the Act of June 1, 1911 be construed not to require of fire insurance companies a fund to be reserved
111 against the item of "unpaid losses and claims", the very excellent rules and practice promulgated and pursued by the Department of Insurance of the State of Pennsylvania, in ascertaining and enforcing the solvency of insurance companies for the protection of policy holders, will be disturbed, and in fact, destroyed. I do not concede this to be true, for if the contention of the government were to prevail, the decision would not affect the Department of Insurance of the State of Pennsylvania or disturb its rules and practice in the least. The result would simply be, first, that the plaintiff fire insurance company would not be permitted to escape taxation under the Corporation Excise Tax Law by making a deduction in one year for losses not yet determined, and thereafter, conceivably, deducting in the next year for the same losses when actually determined and paid; second, the plaintiff insurance company would be taxed only for the privilege of doing business after deducting for losses actually sustained *when* their amounts were precisely ascertained; and third, the Department of Insurance of the State of Pennsylvania would proceed as before and require all insurance companies, seeking the privilege of doing business in Pennsylvania, to disclose assets equal to all liabilities, and stay solvent or stop business. There is no occasion for these results to be confused, as the questions presented in this controversy are separate and distinct. The first is a question for the Department of Insurance of the State of Pennsylvania, and is whether an insurance company is solvent and whether its business is being legally conducted. This fact may be ascertained, as it is now from time to time ascertained, without inquiry as to the requirements of the laws of Pennsylvania respecting the maintenance of reserve funds.

The other question is one for the United States Commissioner of Internal Revenue, and is whether anything more than a "reinsurance reserve" is required by the laws of Pennsylvania to be maintained by a fire insurance company as distinctively a reserve fund. If nothing more is found in the law, then the Federal government can lay its tax and disallow deductions for unpaid losses and contingent expenses, without regard to the conduct of the Insurance Department of the State of Pennsylvania in treating the same items to determine the solvency of the company.

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I concur with the view expressed in the majority opinion, that the fact that the plaintiff insurance company had a surplus neither determines what is required by the law of Pennsylvania with respect to reserve funds, nor gives to an insurance company the right to a deduction under the Federal statute, when without a surplus it would be without such a right. It was upon the fact that the plaintiff insurance company had a surplus that the District Court disallowed the deduction, after having held, as this court holds, that the laws of Pennsylvania, when construed in the light of practice, require reserve funds against unpaid losses and claims of fire insurance companies. It is upon this point that I am embarrassed in finding myself at variance with the reasoning of both the trial court and the appellate court.

For the reasons that I have given, I am of opinion that the deductions were properly disallowed, and that recovery for the amounts paid should be denied.

Endorsed: No. 1916. Dissenting Opinion by Woolley, J. Received and filed July 6, 1915. Saunders Lewis, Jr., Clerk.

113 In the United States Circuit Court of Appeals for the Third Circuit.

No. 1916 (List No. 16) March Term, 1915.

INSURANCE CO. OF NORTH AMERICA, PLAINTIFF IN ERROR,

vs.

WM. MCCOACH, COLLECTOR, DEFENDANT IN ERROR.

In Error to the District Court of the United States, for the Eastern District of Pennsylvania.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Eastern District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and the same is hereby reversed, with costs, with instructions to allow the claim.

Philadelphia,
July 6, 1915. (Signed) JOHN B. MCPHERSON,
Circuit Judge.

Endorsed: No. 1916. Order Reversing Judgment, etc. Received and filed July 6, 1915. Saunders Lewis, Jr., Clerk.

114 UNITED STATES OF AMERICA,
Eastern District of Pennsylvania } *scr.*
Third Judicial Circuit.

I, SAUNDERS LEWIS, Jr., Clerk of the United States Circuit Court of Appeals, for the Third Circuit, do hereby Certify the foregoing to be a true and faithful copy of the original transcript of record and proceedings in this Court in the case of Insurance Co. of North America, Plaintiff in Error, vs. William McCoach, Collector, Defendant in Error, on file, and now remaining among the records of the said Court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this twenty-sixth day of April in the year of our Lord one thousand nine hundred and sixteen and of the Independence of the United States the one hundred and fortieth.

[SEAL.] (Sgd) SAUNDERS LEWIS, Jr.
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

( )

77 UNITED STATES OF AMERICA, *ss:*

The President of the United States of America, to the honorable the Judges of the United States Circuit Court of Appeals for the Third Circuit, greeting:

Being informed that there is now pending before you a suit in which Insurance Company of North America is plaintiff in error, and William McCoach, collector of internal revenue, is defendant in error, No. 1916, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the Eastern District of Pennsylvania, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Supreme Court of the United
78 States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the honorable Edward D. White, Chief Justice of the United States, the twenty-sixth day of May, in the year of our Lord one thousand nine hundred and sixteen.

JAMES D. MAHER,
Clerk of the Supreme Court of the United States.

1916. File No. 25,281. Supreme Court of the United States, No. 998, October Term, 1915. William McCoach, collector of internal revenue, *vs.* Insurance Company of North America. Writ of certiorari. Received and filed May 31, 1916. Saunders Lewis, jr., clerk.

79 In the Supreme Court of the United States—October Term, 1915.

WILLIAM MCCOACH, COLLECTOR OF INTERNAL REVENUE, petitioner, *vs.* INSURANCE COMPANY OF NORTH AMERICA.	No. 998.

Stipulation as to return to writ of certiorari.

It is hereby stipulated by counsel for the parties to the above-entitled cause that the certified copy of the transcript of record now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Third Circuit to the writ of certiorari granted therein.

(Signed) JNO. W. DAVIS,
Solicitor General.
G. W. PEPPER,
Counsel for the Respondent.

MAY 27, 1916.

(Endorsed:) No. 1916. Stipulation of counsel. Received and filed June 10, 1916. Saunders Lewis, jr., clerk.

80 UNITED STATES OF AMERICA,
Eastern District of Pennsylvania, Third Judicial Circuit, sct.

I, Saunders Lewis, jr., clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original stipulation of counsel as to return to writ of certiorari in the case of William McCoach, collector of internal revenue, petitioner, *vs.* Insurance Company of North America, on file, and now remaining among the records of the said court in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said court, at Philadelphia, this twelfth day of June, in the year of our Lord one thousand nine hundred and sixteen and of the Independence of the United States the one hundred and fortieth.

[SEAL.] SAUNDERS LEWIS, jr.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

(Endorsed:) File No. 25,281. Supreme Court U. S. October term, 1916. Term No. 475. William McCoach, collector, etc., petitioner, *vs.* Insurance Company of North America. Writ of certiorari and return. Filed June 13, 1916.

No. 475.

In the Supreme Court of the United States.

OCTOBER TERM, 1916.

WILLIAM MCCOLGIN, Collector of Internal Revenue,
PETITIONER,

vs.

LIQUIDATING TRUSTEES OF NORTH AMERICA.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENTS.

In the Supreme Court of the United States.

OCTOBER TERM, 1916.

WILLIAM MCCOACH, COLLECTOR OF INTERNAL REVENUE, petitioner,
v.
INSURANCE COMPANY OF NORTH AMERICA. } No. 475.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

MOTION TO ADVANCE.

Comes now the Solicitor General and moves the court to advance the above-entitled cause for hearing on a day convenient to the court.

This action was brought by the Insurance Company of North America to recover taxes assessed against that company under the corporation tax act of August 5, 1909, 36 Stat. 11, 112, 113, for the years 1910 and 1911, and paid by it under protest.

The question involved is the meaning of certain phrascology contained in that part of the corporation tax act, 36 Stat. 112, 113, and the present income tax act, 38 Stat. 172, 173, providing for deductions by insurance companies in ascertaining the

net income upon which they are to be taxed under the provisions of said act. The question was stated with particularity in the petition for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit granted by this court on May 22, 1916. For that reason it is deemed unnecessary to repeat at length here the facts of the case, and reference is made to the petition which was filed on May 4, 1916, for a full statement thereof.

The case is one of importance to the Treasury Department in the collection of the Federal revenues. The decision of this court will determine whether the present method of assessment by that department is correct and whether millions of dollars already assessed and collected are refundable. For these reasons an early determination by this court is desirable.

Notice of this motion has been served on opposing counsel.

JOHN W. DAVIS,
Solicitor General.

NOVEMBER, 1916.

○

In the Supreme Court of the United States.

OCTOBER TERM, 1915.

WILLIAM MCCOACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,
v.
INSURANCE COMPANY OF NORTH AMERICA.
} No. ——.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

To the Supreme Court of the United States:

The Solicitor General, on behalf of William McCoach, Collector of Internal Revenue, prays for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Third Circuit in the above-entitled cause.

QUESTION PRESENTED.

The Corporation Tax Act (36 Stat. 112, 113), after levying a tax of 1 per cent upon the net annual income over $5,000 of every corporation doing business, provides that this net income shall be ascertained by deducting from the gross income received within the year from all sources certain specific items, among which is the following:

> * * * (second) all losses actually sustained within the year and not compensated

> by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and *in the case of insurance companies* the sums other than dividends, paid within the year on policy and annuity contracts and *the net addition, if any, required by law to be made within the year to reserve funds;* * * *.

The present Income Tax Act (38 Stat. 172, 173) has the same deduction (par. G, subd. (b)):

> And in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds * * *.

The question in the case at bar is, what is meant by the phrase "in case of insurance companies the net addition required by law to be made to reserve funds," and particularly whether the term "reserve funds" covers claimed deductions on account of ordinary liabilities, such as "unpaid losses and claims."

STATEMENT OF THE CASE.

The action was brought to recover taxes for the years 1910 and 1911, paid under protest. The complaint alleged that the company had deducted from its gross income for each of these years a sum representing the increase in the net amount of its unpaid losses and claims over the preceding year. (R. 10, (c); R. 12, (i); R. 44, par. 6, subd. (1); R. 45, par. 7, subd. (1).) The Government refused to allow this deduction (R. 10, (d), (1) and (2); R. 13, (j), (1) and (2)); because it did not constitute a net addition to "reserve funds." A jury was waived

(R. 43), and the case was tried partly on a stipulation of facts and partly on oral testimony. The District Court decided in favor of the Collector. (218 Fed. 905.) He held that the company was "required by law" to keep a "reserve" to cover "unpaid losses and claims," but that the "surplus" of the company, amounting to from $2,500,000 to $4,000,000, was part of that "reserve," so that no "addition" thereto was required in either of the two years.

The Court of Appeals (Woolley, J., dissenting in a reasoned opinion) reversed the judgment, and held (224 Fed. 657):

(*a*) That "required by law" meant required by the law of the particular State;

(*b*) That the Pennsylvania law "required" a "reserve fund" against "unpaid losses and claims."

The Pennsylvania law in question (act June 1, 1911, Laws 1911, p. 607) provides by section 15 that every insurance company shall make an annual report to the insurance commissioner on a form which shall seem to him best adapted "to elicit from them a true exhibit of their financial condition." The returns of the Insurance Company of North America for the years 1909, 1910, and 1911 show under the heading "Liabilities": (1) "Net amount of unpaid losses and claims," which is made up of losses adjusted and unpaid, losses in process of adjustment, and losses resisted; (2) "*Total unearned premium*," which is made up of unearned premiums on fire risks running one year or *less*, on risks running *more* than one year, on inland navigation risks, and on marine risks;

(3) interest, salaries, expenses, etc.; (4) taxes; (5) commissions and brokerage. To these items in order to give the total liabilities is added (6) capital and surplus.

These are referred to because the Circuit Court of Appeals relied somewhat upon them as constituting a departmental ruling and usage, and also upon the testimony of the Deputy Commissioner of Insurance (R. 50–78) as having the same effect.

REASONS FOR THE ALLOWANCE OF THE WRIT.

(1) The Circuit Court of Appeals misconstrued the Pennsylvania statute in holding—

(*a*) That under it "reserve funds" is not confined to "reserve for reinsurance" or "total unearned premium," but includes also "unpaid losses and claims";

(*b*) That the law vested the insurance department of the State with jurisdiction to determine administratively what constitutes the "reserve funds" of an insurance company.

(2) The case is one of great importance to the collection of Federal revenues. The gross income of insurance companies subject to the acts throughout the United States is enormous. By both acts they are permitted to deduct from this gross income all that other corporations are permitted to deduct. In addition they are allowed the peculiar deduction of the annual increase in their "reserve funds." The decision of the court below explicitly makes this include the annual increase in their unpaid losses and

claims—though admittedly not actually paid within the year in question—and by inference may be claimed to permit the deduction of the annual increase in all their liabilities of whatsoever character. The effect of this ruling upon the tax returns of insurance companies under these acts can not be foreseen, but the Treasury Department states that it will cause a very large annual loss to the revenues of the United States.

BRIEF IN SUPPORT OF PETITION.

(*a*) The Court of Appeals held that Congress did not intend by the term "reserve funds" "in the case of insurance companies" to cover merely what is technically known in the insurance business as "reinsurance reserve" or "net value," but also "such funds as must be reserved to meet liabilities, whether they be contingent or already adjusted" (224 Fed. 659), because Congress did not use "that well-known term of art," but used "the plural form, reserve funds." Every presumption, however, is against this. The term "reserve," or "reserve fund or funds," has a different meaning in different businesses, and in the Corporation Tax Act Congress, by confining the deduction to "the case of insurance companies" clearly intended the "reserve funds" which are known as such in the insurance business; just as an enactment dealing with the "reserve" or "reserve funds" of national banks would necessarily refer to the reserve against circulating notes. This is especially true since "reserve" or "reserve funds" has for many

years had no other meaning in the insurance business than a definite, technical one.

In Vance on Insurance, p. 39, the following definition is given:

> *The Meaning and Function of the Reserve Fund.* Under the ordinary level rate life policy, if it is not allowed to lapse by the insured, the sum promised to be paid by the insurer will certainly become due at a future time, which, though uncertain in every individual case, yet in the average may be ascertained with reasonable accuracy from the experience tables. The insurer is obliged to make provision for such payment, and must from the premium received each year set aside or reserve a sufficient amount to enable him to discharge his obligation when it matures. This accumulated fund, which is seen to measure the ability of the insurer to keep his promise for payment, is known as the "reserve fund."

So Dawson's Elements of Life Insurance, third edition, p. 183:

> *Reserve:* Literally a sum held in reserve. But in life insurance synonymous with the "value" of a policy. It may be considered from the "retrospective" (that is, as an "unearned premium" reserve) or from the "prospective" standpoint (that is, as a "reinsurance" reserve). From the latter standpoint it must be a sum sufficient, together with future net premiums, mortality and interest being as assumed, to enable the company to discharge its policy obligations. From the for-

> mer standpoint it consists of what should remain of the net premiums collected in the past after meeting all policy obligations, interest and mortality being as assumed. This is the American view, based upon the proposition that loadings which have been imposed to provide for expenses and contingencies, must be treated as required for that purpose, and consequently that net premiums only can be taken into account in computing reserves.—See pp. 93, et seq.

And p. 177, the following:

> *Legal Reserve:* The mathematically adequate reserve required by law.

In Eldridge's Principles of Reservation in their Application to Legislative Regulation of Life Insurance, quoting section 11 of the Massachusetts insurance law, which provides how the insurance commissioner shall compute the "net value" of policies, the author says, pp. 7, 8:

> This clause provides the standard by which the "net value" is to be determined, but noticeably it does not define the words "net value"—which net value is what is popularly spoken of as the reserve. It is, therefore, a perfectly legitimate conclusion—in fact, an unavoidable conclusion—that the term has a fixed and definite meaning in life insurance, rendering it unnecessary that it should be defined * * *.

And again, p. 9:

> The net value of a policy,—the reserve liability thereunder,—is, therefore, not an intan-

> gible something created by law, but a reality inherent and necessary to the conditions of a contract that on the one hand agrees to give a benefit the cost of which increases with passing years, and on the other to accept pay therefor by fixed limited and uniform periodical payments, called premiums.

And he concludes on p. 17:

> 2. The office of the statutory standard is simply to establish an authoritative measure of values from which to determine the amount of reserve required; * * * .

In Yale Readings on Insurance—Life—on pp. 193, 194, it is said:

> The laws of the several states prescribe the the maximum rate of interest that may be assumed, and the mortality table that shall be used, in computing the reserve or net value of a company's policies. This requirement is termed the *legal standard of valuation*. The net value computed by the legal standard is termed the *legal net value or legal reserve*.

In Yale Readings on Insurance—Fire—at p. 23, it is said that in 1837 "the State of Massachusetts provided that companies should maintain a fund to insure their contracts being carried out, and this was the beginning of what is known as the unearned premium fund * * *.

"The development of this idea of reservation is interesting, especially in view of the fact that it is recognized to-day as one of the corner stones of successful fire underwriting."

(And see pp. 149, 150, 243, where reserve of fire insurance companies as required by law is treated of.)

In the leading case of *Fuller* v. *Mutual Life Insurance Company*, 70 Conn. 647, 665, it is said:

> Where a policy thus lapses the company has in hand the accumulations of a portion of its premiums invested and held in reserve to supply the insufficiency of future premiums to pay future cost of insurance. (The amount thus held in reserve depends on the judgment of the company in calculating its premiums and the condition of its business, but the statute treats the company as insolvent unless its whole reserve is at least equal in amount to the reserve value of all the policies *calculated according to a rule established by law*. Some companies accumulate a reserve larger than that required by statute; none can have less and remain solvent.) [Italics mine.]

In *State ex rel.* v. *Vandiver*, 213 Mo. 187, 213, 214, the court said:

> What is known in the language of life insurance as the "reserve" existed long before either by contract or by statute any part of it was devoted to extended insurance. In 7 Words and Phrases, p. 6147, the term "reserve fund" is thus defined: "When the term is applied to a level-rate policy, it means a sufficient percentum of the annual premiums to meet, when invested at a given rate of interest, all present and prospective liability on account of the particular policy. When applied to term insurance, it means the entire

> mortuary premiums collected for the particular term. It has no application to assessment insurance.

In *Detroit Fire and Marine Insurance Company* v. *Hartz*, 132 Mich. 518, 520, the court said:

> * * * The fund called the "reserve fund" is the property of the company. For the purpose of protection to patrons of the company, *the law requires* it to be kept in a fund called a "reinsurance reserve fund," so that the company may have the means to reinsure its risks if necessary, which it is given power to do; but its character is not changed on that account. See 2 Comp. Laws, sec. 5169. [Italics mine.]

In *Bankers Life Insurance Company* v. *Howland*, 73 Vt. 1, 15, it is said:

> The term "net valuation" is nowhere used in our statutes, we have no statutory definition of it; the phrase in our law is the "premium reserve" which may be regarded as its synonym, but its generally accepted meaning is that it is the amount the company must have in hand which with its future premiums will enable it to meet its policy obligations. The statute makes no attempt to regulate the manner in which the net value shall be determined save by requiring the use of the actuaries' tables of mortality, and the 4 per cent rate of interest.

In *Wright* v. *Minnesota Mutual Life Insurance Company*, 193 U. S. 657, 662, in holding that a certain change in the charter of a life insurance com-

pany did not violate any vested rights of the stockholders, the court said:

> The complaining certificate holders allege that the laws of Minnesota, under which the changes in the plan of insurance business done by the defendant company were made, from the assessment to *the legal reserve*, flat premium plan of "old line" insurance, work a violation of that provision. [Italics mine.]

These authorities—and we can find none to the contrary—demonstrate that when the Corporation Tax Act was passed there had for many years been recognized by law and by usage in the insurance business a definite conception called "reserve," "reserve fund," "premium reserve," "net value," which denoted that amount of the gross premium which, assuming a certain table of mortality and a certain rate of interest, must be retained in order to meet the contingent liability of the policy when it matured. This conception must almost certainly have been the one in the mind of Congress when it spoke of "reserve funds" "in the case of insurance companies." At any rate, this conception must be constantly borne in mind in construing such a standard statute as the Pennsylvania Insurance Code.

(*b*) The Pennsylvania act starts out by establishing an insurance department and creating an insurance commissioner. Section 4 prescribes his duties. By paragraph 1 he is to enforce the law, and for that purpose to make examinations. By paragraph 2 he may suspend the business of any company "when-

ever he shall find that its assets are insufficient to justify its continuance in business;" and by paragraph 3 he may apply to a court for dissolution, etc., on the same ground. By paragraph 7 he must annually compute "the reserve liability" of life insurance companies, according to certain tables of mortality and rates of interest, with an additional reserve when the premium charged is below the standard premium. By paragraph 8 it is provided that "the aggregate net value so ascertained of the policies of any such company shall be deemed its reserve liability to provide for which it shall hold funds in secure investment of an amount equal to such net value, above all its other liabilities." By section 5, when a life insurance company has not on hand such net value above all other debts and claims against it, including 50 per cent of its capital, it can issue no new policies.

Coming to fire insurance companies and to sections 7, 8, and 9, which are the particular sections involved in the present case, section 7 provides that "in determining the liabilities upon its contracts of insurance of any insurance company other than life insurance, and the amount such company should hold *as a reserve for reinsurance*," the commissioner shall, for fire and marine insurance, charge a certain per cent of the premiums according to the length of time the policy has to run. By the same section he is to charge *against casualty companies* one-half their premiums as a reinsurance reserve. Section 8 then provides that "he shall, *in calculating the reserve against*

unpaid losses of casualty companies," set down carefully the probable loss, "and the sum of the items so estimated shall be the total amount *of the reserve" of such casualty companies.*

Section 9 then provides, "having charged as a liability *the reinsurance and loss reserves, as above defined,"* of companies other than life, "and *adding thereto all other debts and claims* against the company, the commissioner shall, in case he finds the capital of the company impaired 20 per centum, give give notice to the company to make good the capital within 60 days."

Reading sections 7, 8, and 9, then, in the light of the long, well-established meaning of "reserve" and "reserve funds" of an insurance company, and of the earlier sections relating to life insurance companies, it seems clear that the only "reserve" of fire insurance companies referred to and intended is the "reinsurance reserve" provided for by section 7. As to life insurance companies the net value is expressly called the *reserve* liability, and the only reference to other liabilities appears to be section 5, where reserve is given as the residuum after "providing for" all other debts and claims, and capital is included among such other debts and claims. Surely capital can not be considered part of the "reserve funds" Congress was speaking of as an allowable deduction. It seems clear, therefore, that as to life insurance companies "unpaid losses and claims" can not be included among "reserve funds," and it seems improbable

that any different result was intended by the Pennsylvania act as to fire insurance companies.

As to fire and marine insurance companies, it is expressly provided that they must hold a certain amount of their premiums as "a reserve for reinsurance." Nothing is said, so far as they are concerned, of any "reserve" against "unpaid losses and claims." But as to casualty companies it is provided by section 8 that they shall hold a "reserve" against "unpaid losses." This is not difficult to understand, because "in casualty insurance the net cost has not yet been reduced to a science, and until such time as the experience of all companies is collected and the proper rule established it will be impossible to compute the reserve on casualty policies by any such method as is used by life insurance companies."

Before, therefore, section 9 is reached there is clearly defined a "reserve for reinsurance" as to fire and marine insurance companies and a "reserve for unpaid losses" as to casualty companies. Section 9 then provides that after the commissioner has charged against these companies as liabilities these two kinds of "reserves," he shall add thereto "all other debts and claims"; but for what purpose? As a "reserve fund required by law"? Not at all. Merely in order to determine whether the company's capital is impaired 20 per cent, in which case it must contract its business and repair its capital. There is no intimation that any "reserve" is "required" against these "other debts and claims." On the contrary, the

balance when struck might show an impairment of capital of 19 per cent and yet the company would be within the law.

The only reason given by the majority of the Circuit Court of Appeals for its construction of the act is as follows (224 Fed. 661):

> Such unpaid losses are "claims against the company," and in our opinion the Pennsylvania law (while it may be somewhat lacking in precision of statement) required them to be added to the company's liabilities, *and required funds to be reserved to meet them in full.*

The law undoubtedly required that the company should have assets, including as assets 20 per cent of its capital stock, sufficient to meet all its liabilities, or else should restrict its business and repair its capital. It seems clear, however, that these general assets, including a portion of the capital, are entirely different from its "reserve funds," the standard of which is specifically defined, and to which standard it must absolutely conform; and entirely different from those "reserve funds" which Congress permitted to be deducted. To say that assets generally, including a portion of those held against capital, may be deducted from gross income to get net income seems a *reductio ad absurdum.*

It is expressly provided that casualty companies shall keep a "reserve" against "unpaid losses." *Expressio unius est exclusio alterius.* This requirement as to casualty companies compels the conclusion that there is no such requirement as to other companies,

and, therefore, that fire insurance companies are not "required" to keep a "reserve" against "unpaid losses."

The construction placed by the Court of Appeals upon section 9 is so broad as to defeat itself. "Other debts and claims" would include Federal taxes, *e. g.*, the very tax now in controversy. In fact, as pointed out by Judge Woolley, 224 Fed. 664, the insurance company, in its report to the insurance commissioner, did include under this heading the tax now in dispute. Hence, according to the decision of the Court of Appeals, a "reserve" "is required" against these taxes, and consequently such a reserve may be deducted from gross income, under the Corporation Tax Act, an evidently vicious circle.

Moreover, "unpaid losses and claims" are not, by their very definition, "losses actually sustained within the year," which is the only deduction of this character permitted by the Corporation Tax Act. If the company be permitted to deduct these unpaid losses under such a heading, there appears to be no reason why it could not deduct them again in the year when they are actually paid.

The Court of Appeals also placed its decision partly upon the ground that for years the act had been construed in this way by the insurance department of the State in its administration of it. To this there are two answers:

1. There is no ambiguity in the act to be explained by administrative construction, and the case falls

within the decisions in *Swift Co.* v. *United States*, 105 U. S. 691, 695; *United States* v. *Graham*, 110 U. S. 219, 221; *Studebaker* v. *Perry*, 184 U. S. 258, 269.

2. The determination of what constitutes the "reserve funds" of a fire insurance company under the laws of Pennsylvania is not submitted to the insurance department of that State for administrative construction. Section 15 of the act requires reports to the commissioner on forms prescribed by him, the object of which is to give "a true exhibit of their financial condition." The commissioner, therefore, has jurisdiction to determine what shall be included in the list of liabilities in order to show the financial condition of the company; but no jurisdiction is conferred on him to determine what portion of these liabilities is "reserve funds," and what is not, and his ruling on this point, if he ever made one, is *coram non judice*.

(*c*) It is respectfully submitted that the writ should issue as prayed.

JOHN W. DAVIS,
Solicitor General.

APRIL, 1916.

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In the Supreme Court of the United States.

OCTOBER TERM, 1916.

WILLIAM MCCOACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER,
v.
INSURANCE COMPANY OF NORTH AMERICA. | No. 475.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR PETITIONER.

STATEMENT OF THE CASE.

This is a suit by a Pennsylvania fire and marine insurance company to recover taxes for 1910 and 1911 under the Corporation Excise Tax Act of 1909, 36 Stat. 11, 112, which taxes were paid under protest because there was not allowed, as a deduction from income, amounts added in each tax year, to its "reserve funds," as for "unpaid losses" on claims.

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A jury was waived and a trial had by the court on stipulated facts and oral testimony. The material agreed facts are:

That in 1912 the Commissioner of Internal Revenue assessed against the plaintiff an additional excise tax under the act of August 9, 1909, 36 Stat. 112, of $8,875.91 for 1910 and $1,072.35 for 1911. That plaintiff paid these taxes in such manner as to preserve his right to sue on his claim, which was that $1,600.53 of the 1910 tax, and the whole of the 1911 tax, was illegally assessed. This $1,600.53 consists of $1,517.50 (as 1 per cent on the amount claimed to be legally required as an addition to reserve funds for "unpaid losses"), and another item not material here because confessed by the Government, while the 1911 tax represents similar items after some small but immaterial adjustments. (R. 31.)

That the financial reports of the company to the State Insurance Commissioner were on forms adopted by him and used by all insurance companies in the State, and showed the financial operations for 1909, 1910, and 1911, respectively, including liabilities and disbursements. These reports were examined by the District Court (R. 32, 60) and the Court of Appeals (R. 68, 73) and by stipulation of counsel are not printed in the transcript of record, but are filed in this court to be referred to as needed.

That in each tax year the total outstanding policy losses unpaid exceeded that of the preced-

ing year. That the amount of that excess was credited each year as part of the reserve fund claimed to be required by law, and these were the items the tax on which is in dispute. (R. 31.) It further appeared that the company's surplus was at all times between two and one-half and four and one-quarter millions. (R. 61.)

The oral testimony related to the understanding of those in the business as to the meaning of "reserve funds" and the practice of the State Insurance Department in that regard. (R. 32.)

The trial court held (1) that "required by law" in the Federal Tax Act meant by State law; (2) that the State law required a reserve fund against "unpaid losses" on claims; (3) that the surplus must be deemed a part of the "reserve funds" and therefore these funds were ample to satisfy the law without the additions, and accordingly denied recovery (218 Fed. 905). The majority of the Court of Appeals reversing the judgment below, held with the trial court on (1) and (2) above; but ruled that surplus could not be deemed a part of the reserve funds (224 Fed. 652). Judge Wooley, in dissent, urged that the State statute did not require any reserve for "unpaid losses" on claims.

The single question before this court is whether the law of Pennsylvania required fire and marine insurance companies to maintain reserve funds to meet "unpaid losses" on claims.

THE STATUTES.

To determine " net income " the Excise Tax Act, 36 Stat. 113, provides that from the " gross income " there shall be deducted

> * * * (Second) All losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and *in the case of insurance companies* the sums other than dividends paid within the year on policy and annuity contracts and *the net addition, if any, required by law to be made within the year to reserve funds;* * * * (Italics ours.)

The law of Pennsylvania (Act of June 1, 1911, P. L. 607, 608) creates a State Insurance Commissioner with supervisory control over the companies, and provides:

> Section 4. * * *
>
> Second — * * *. He shall suspend the the entire business of any insurance company of this commonwealth, * * * whenever he shall find that its assets are insufficient to justify its continuance in business * * *
>
> Section 7. In determining the liabilities upon its contracts of insurance of any insurance company other than life insurance, and the amount such company should hold as a *reserve* for reinsurance, he shall, for casualty insurance companies, charge, one-half of the premium on all annual policies written within one year, and on policies

written for more than one year he shall charge one-half of the current year's premiums, plus the whole of the premiums for subsequent years. For *fire* insurance companies he shall charge fifty per centum of the premiums written in their policies upon all unexpired risks that have one year, or less than one year, to run, and a pro rata of all premiums on risks having more than one year to run; and on perpetual policies he shall charge the deposit received, less a surrender charge of not exceeding ten per centum thereof. For *marine* and inland risks he shall charge fifty per centum of the premium written in the policy upon yearly risks, and the full amount of the premium written in the policy upon all other marine and inland risks not terminated.

Section 8. He shall, in calculating the reserve against unpaid losses of casualty companies, other than losses under liability policies, set down by careful estimate in each case the loss likely to be incurred against every claim presented, or that may be presented in pursuance of notice from the insured of the occurrence of an event that may result in a loss; and the sum of the items so estimated shall be the total amount of the reserve.

Section 9. Having charged as a liability the reinsurance and loss reserves, as above defined for insurance companies of this commonwealth other than life, and adding thereto all other debts and claims against

the company, the Commissioner shall, in case he finds the capital of the company impaired twenty per centum, give notice to the company to make good the capital within sixty days.

ARGUMENT.

IN PENNSYLVANIA NO RESERVE FOR "UNPAID LOSSES" IS "REQUIRED BY LAW."

1. None required by business usage. If there were, it would be immaterial.

Evidence was introduced to show that according to business understanding in Pennsylvania "reserve funds" includes "unpaid losses" as well as "reinsurance reserves" (R. 35, 54). This seems contrary to the general business and legal understanding of the phrase (*Vance, Insurance,* p. 39; *Dawson, Life Insurance,* 3d Ed., p. 183; *Eldridge, Principles of Reservation,* pp. 7–8; *Yale Readings on Insurance—Life,* p. 194; *Detroit Fire & Marine Insurance Co.* v. *Hartz,* 132 Mich. 518, 520; *Fuller* v. *Metropolitan Life Insurance Co.,* 70 Conn. 647, 665; *State* v. *Vandiver,* 213 Mo. 187, 213). In any event it is irrelevant, since the Federal tax act "specifically limits the deduction to sums *required by law,* not such reservations as business prudence may suggest." *Maryland Casualty Co.* v. *United States,* Ct. Claims, Feb. 12, 1917, adv. sheets, p. 24. The Pennsylvania law clearly defines the particular reserve funds it requires, and establishment of other reserves as a business custom can not bring them within the statute.

This court in *Von Baumbach* v. *Sargent Land Co.* (decided January 15, 1917) had recourse to business custom to determine the meaning of the word " depreciation " in this statute, but that was because the statute does not define the word. Such recourse to determine the meaning of " income " was held error in *Anderson* v. *Forty-two Broadway Co.*, 239 U. S. 69, 72, because the statute itself declared the meaning of the word.

2. Exemptions from taxation here claimed must be strictly construed.

The insurance statutes are resorted to in order to define the words in a tax law. The words are used to exclude certain premiums—unquestionably a part of the income—from entering into the measure of taxation, and by familiar principles should be construed strictly against the exemption. *Delaware Railroad Tax*, 18 Wall. 206. Thus, in an analogous case, *Newark* v. *State Board of Equalization*, 81 N. J. L. 416, 421, the court said:

> The right given by the statute, to the company, to deduct from the amount or value of its property the amount of its liability on its policies, is, in its essence, a grant of exemption from taxation; and it is a fundamental rule in the law of taxation that such grants will never be permitted to extend, in scope, beyond what the terms of the concession clearly require, and that all doubts as to the scope of the exemption must be resolved in favor of the state.

The claimed exemption would involve a deduction for a loss not actually paid, contrary to the general intention of the statute (*Edwards* v. *Keith,* 231 Fed. 110; *Baldwin Locomotive Works* v. *McCoach,* 215 Fed. 967; 221 Fed. 59; *Connecticut Mutual Life Insurance Company* v. *Eaton,* 218 Fed. 206), wherefore the sole exception in favor of " reserve funds " should be made as narrow as possible.

No argument for broadening the meaning of " reserve funds " can be drawn from its plural form. The tax act used " insurance companies " in the plural and it was natural to use " reserve funds " in the same form. Moreover, statutes sometimes require more than one kind of reserve fund for different companies (as the Pennsylvania statute here involved does for casualty companies) and the Federal statute dealing with funds of all companies necessarily uses the plural to meet such situations.

3. " Unpaid loss " reserves are not required of fire or marine insurance companies by Pennsylvania statutes.

There are several ways to protect policyholders against improperly financed companies. Each item of liability might be considered separately and a reserve required to meet it. No statute so awkward, however, has been discovered. Or without requiring any reserves (except, perhaps, certain deposits with public officials) the statute

might provide that the general financial condition of the company, to be determined by official inspection, must always be adequate. Such is the method in Florida (Comp. Laws, 1914, sec. 2765 ff.), South Carolina (Code, 1912, sec. 2690 ff.), and Virginia (Pollard's Code, 1914, sec. 1266). Or, finally, in addition to the general requirement of a sound fiscal condition, a reserve might be established for *particular* liabilities. This is the situation in Pennsylvania.

Under the last system, a distinction is made between items to be included in the general liabilities and covered by the general assets, and items for which specific funds are contemplated. The requirement that there must be *general assets* adequate to meet liabilities does not demand a reserve fund for every liability. Examination of the Pennsylvania statutes shows that no reserve funds are required except the " reinsurance reserve " in the case of life, fire, and marine companies, and the " reinsurance reserve " and " unpaid loss reserve " for casualty companies.

The act of March 21, 1873 (P. L. 20), required a reserve of the net value of life policies and a reinsurance reserve for fire, marine, and inland risks. No other reserve fund was mentioned or implied therein.

The act of June 1, 1911, amplifies this statute, reenacting provisions almost identical as to reserve. The last three subdivisions of section 4 give

the formula for computing the net valuation or reinsurance reserve of *life* policies, and add:

> The aggregate net value so ascertained of the policies of any such company shall be deemed its reserve liability.

No reference is made to any other reserve.

Section 7 makes entirely analogous provision for insurance other than life, the only difference being that the reserve, as is customary in such insurance, is called "*reinsurance* reserve" rather than "net valuation."

Conclusive evidence that "unpaid loss" reserves were not contemplated for fire or marine companies is found in the fact that section 8 expressly prescribes such a reserve (in addition to the reinsurance reserve already provided by sec. 7) for casualty companies, and for *casualty companies only*. The act of 1873 made no provision for casualty companies and required no unpaid loss reserves at all. Introduction of provisions for unpaid loss reserves came with provisions for casualty companies and the specific differentiation against the casualty company (based, no doubt, upon the difficulty of accurately estimating a casualty company's reinsurance reserve, Yale Readings in Insurance, Fire, p. 384), indicates the intention not to require "unpaid loss" reserves of other companies.

Nothing contained in section 9 militates against this contention. It follows immediately upon the establishment of reinsurance reserves for all com-

panies and unpaid loss reserves for casualty companies. Its reference to "reinsurance and loss reserves, *as above defined*," can not enlarge those definitions and imply a loss reserve for companies other than casualty. In cooperation with the second subdivision of section 4 it merely provides generally for assets to meet liabilities independently of reserves. It would operate, though reserves were intact, if a general balance showed an impairment of capital greater than that allowed; and though there were no reserves, it would not operate if capital were not impaired to that extent.

4. The practice of the State Insurance Department accords with this analysis.

While it was testified that the insurance department compelled the maintenance of unpaid loss reserves (R. 37), this was explained on cross-examination to mean merely that in the reports to the insurance department, the companies were required to charge unpaid losses as *liabilities* (R. 46). No other evidence of a practice or ruling of the insurance department was offered, and it was specifically shown that there were no rules or regulations promulgated nor any opinion delivered on the subject (R. 45, 46). It is therefore unnecessary to point out that the statutes do not authorize the commissioner to require "unpaid loss" reserves, and had he done so he would have transcended his power.

The insurance department's exact action is brought out by the Circuit Court of Appeals in stating that "unpaid losses" were treated in the company's reports to the department as liabilities (R. 68, 69). The fact that they were liabilities or claims and so treated is the only reason given by the court for holding that reserves are demanded for them. That they are *liabilities* is undisputed, but the error lies in the claim that all liabilities must be protected by a reserve.

The extreme to which this reasoning would logically lead is shown by examination of the report for 1911, which is identical with those for 1909 and 1910 in the items listed as liabilities, except that it adds a "contingent fund." Liabilities, as listed on page 5 thereof, show:

Unpaid losses and claims	$1,188,100.00
Unearned premiums	6,655,570.04
Amounts reclaimable on perpetual fire policies	740,601.58
Estimated taxes	90,000.00
Reinsurance premiums	31,701.33
Contingent fund	202,404.41

None of these can be differentiated from any other; and all, by the court's reasoning, must be met by reserves to the amount of each item. The list includes other items, such as—

> Principal unpaid on certificates of deposit ordered redeemed,
>
> Interest due on borrowed money,
>
> Cash dividends unpaid to stock and policy holders,

Salaries, rents, expenses, bills, accounts, fees, commissions, brokerage,
Borrowed money,

which were "blanked" in this report because the company owed no money upon them; but, had the accounts been unpaid, they would be charged as liabilities, and by the reasoning of the court must of necessity have been covered by reserves. So also had any of the items of "disbursements," on page 3 of the report, such as advertising, postage, telegrams, legal expenses, insurance maps, inspection, repairs, heat and light, employees' lunches, etc., not been paid at the time of the report, they must have been listed as liabilities. In fact, capital stock is so listed and, should an increase occur in it or any of the above items, by parity of reasoning, additions to the reserve funds would have to be made, with corresponding deductions from the income for the year in estimating the tax.

In *Maryland Casualty Co.* v. *United States*, Court of Claims, February 12, 1917, the company did casualty insurance in Pennsylvania and three other States. In estimating deductions under the Federal Excise Tax Act, the revenue collector considered a company doing business in several States as maintaining reserves according to the law of the State requiring greatest reserves. Since the Pennsylvania statute expressly requires "unpaid loss" reserves of casualty companies, as well as unearned premium reserves, and this was a casualty company, deductions were allowed for net additions to

both reserves. But the company claimed in 1910 additional deductions for increases in its liabilities for *taxes* and *salaries*, and in 1911 and 1912 for *brokerage* and *reinsurance*, thus courageously advancing the claim in the broadest sense, that reserves are coextensive with liabilities. The court denied the claim and limited reserves to those required by the statutory provision of the State laws, which was what the Government had allowed. (Advance sheets, pp. 23–24.) In the present case a similar limitation would exclude the "unpaid loss" reserves allowed in the Casualty Company case because such reserves are required *only* of *casualty companies*.

5. The company's contention would defeat or postpone indefinitely taxes properly due.

Were the loss settled during the year the company would properly be entitled to a deduction therefor, but the expenditure is not made immediately, and the company remains in enjoyment of the premiums representing the loss. As long as the business is not decreasing and the expenditure represented by the net addition to loss liability is not made, the Government is indefinitely deprived of taxes corresponding to income actually enjoyed, and the statute's intent to deal on a cash basis for outgo and income is defeated.

The unpaid loss liability, except for those claims already adjusted, is a mere estimate presumably greater than the sum finally paid. It furnishes a

convenient hiding place for a too conspicuous surplus. If the deduction is allowed, the company will receive exemptions on an inflated basis.

CONCLUSION.

The judgment of the Circuit Court of Appeals should be reversed and that of the District Court affirmed.

WILLIAM WALLACE, JR.,
Assistant Attorney General.

FEBRUARY, 1917.

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No. 475

In the Supreme Court of the United States

OCTOBER TERM, 1915

WILLIAM MCCOACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER

v.

INSURANCE COMPANY OF NORTH AMERICA

BRIEF ON BEHALF OF THE INSURANCE COMPANY OF NORTH AMERICA

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No.

In the Supreme Court of the United States

October Term, 1915.

WILLIAM McCOACH, COLLECTOR OF INTERNAL REVENUE

Petitioner

vs.

INSURANCE COMPANY OF NORTH AMERICA

BRIEF FOR RESPONDENT

The respondent respectfully submits that the only question involved in this case is whether under the law of Pennsylvania the Insurance Company of North America is required to maintain a reserve for "unpaid losses and claims" and was required by law to make certain additions to such reserve within the years 1910 and 1911.

We understand that the petitioner agrees with the view taken by the District Court and the Circuit Court of Appeals that the clause in the Corporation Tax Act (36 Stat. 112, 113) which permits insurance companies to deduct from their taxable income "the net addition, if any, required by law to be made within the year to reserve funds," refers to the law of the State in which the insurance company was incorporated and is doing business. It therefore follows that the only question at issue is the interpretation of the law of Pennsylvania. Under these circumstances, we submit that there is no real basis for the petitioner's argument that the question is one of great importance to the Federal Government as it affects the taxation of insurance companies throughout the United States. There is nothing upon the record to show that the insurance laws of the other States are so similar to the laws of Pennsylvania as to make the decision of the Circuit Court of Appeals applicable

thereto. We also direct the attention of the Court to the fact that the amount involved in this case is small. The taxes from which the respondent has been exempted by the decision of the Circuit Court of Appeals were, for the year 1910, $1,517.50 and, for the year 1911, $1,130.

We propose to discuss the propositions advanced in the petitioner's brief in the order in which they appear therein.

(a) The petitioner's first proposition is that the term "reserve funds" as used in the Corporation Tax Act has a technical meaning, as applied to fire and marine insurance companies, and includes only the so-called "unearned premium reserve." In support of this contention the petitioner has cited many text books on insurance and certain decisions. The attention of the Court is respectfully directed to the fact that with one exception all of these citations have to do with the reserve for life insurance policies and therefore can cast no light upon the question of what constitutes the "reserve funds" of a fire and marine insurance company. The only decision cited by the petitioner that has to do with a fire insurance company is *Detroit Fire & Marine Insurance Company v. Hartz*, 132 Michigan 518 (1903). The question at issue in that case was whether the reserve fund of the insurance company was taxable under the Michigan law, or whether the amount thereof was an indebtedness which the company was entitled to deduct under the terms of the Tax Act. We submit that this has no bearing upon the question at issue.

The reserve of a life insurance company is entirely different from the reserve of a fire and marine insurance company, and is calculated upon a fundamentally different basis. The established method of calculating life insurance reserves involves the factors of mortality, interest and loading and is carefully prescribed by the laws of the various States. The purpose of all insurance reserves, however, is to make certain that the companies will at all times have on hand sufficient funds to meet their liabilities. The respondent's

contention in the District Court and in the Circuit Court of Appeals was that the "reserve funds" of a fire and marine insurance company include both the "unearned premium reserve" and the "reserve for unpaid losses and claims." These two items cover all of the insurance liabilities of the company. We submit that there is nothing in the authorities cited by the petitioner which in any way controverts our contention upon this point. The record contains clear and uncontradicted evidence in support of this view. The respondent called the Deputy Insurance Commissioner of Pennsylvania, who has been in the Insurance Department of Pennsylvania since 1883, who testified in part as follows:

> "Q. Having in view your experience in the business of insurance, would you state to the Court what you understand to be the generally accepted and established meaning of reserve funds of an insurance corporation?
>
> * * * *
>
> A. First, the amount that should be set aside for the losses that occurred and had not been paid or determined; and, second, the amount that is to be returned to policyholders or used as re-insurance on policies that have not matured.
>
> Q. This second item that you refer to is what is commonly known as the re-insurance reserve, is it not?
>
> A. Re-insurance reserve, unearned premium fund, in a fire insurance company.
>
> Q. And the two items that you have referred to cover all the policy obligations of an insurance company, do they not?
>
> A. All the policy obligations." (R. 52-53.)

The respondent also called the Secretary and Treasurer of the Fire Association of Philadelphia who had been in the fire insurance business for forty-five years, who testified in part as follows:

"Q. Will you state what, in your opinion, you consider as properly represented in the reserve fund of a fire and marine insurance company?

A. I would consider, in view of both the amount reserved for unpaid losses and also the amount for returned premiums, that they are both matters relating directly to the underwriting business. It is the contract between the company and the assured. * * *

By THE COURT:

Q. I understand all these various amounts and practices have a meaning that is understood by the people in the business. It may not convey the same idea to people that are not in the business. That is why Mr. Pepper asks you that question, that in the insurance world, when a reserve fund is spoken of what does that reserve fund include with respect—you need not go into all the items, but what we are interested in —with respect to the unpaid losses and an insurance risk which is still outstanding, or, in other words, the unearned premium feature.

A. Both items, the amount reserved for unpaid losses and the amount reserved for unearned premiums." R. 79-80.)

If, then, we agree with the petitioner that the words "reserve funds" must be given their technical meaning, it is found that this meaning is in accord with the respondent's contention and with the decision of the Court below.

The petitioner contends that the Circuit Court of Appeals has placed too broad an interpretation upon the words "reserve funds," and that it might be possible to contend thereunder that an insurance company is required to maintain a reserve for liabilities of every description and claim the right to deduct net additions to such reserves. It must be borne in mind, however, that the only question before the Court was whether the respondent is required to main-

tain a reserve for "unpaid losses and claims," and no such contention as the petitioner suggests is made by the respondent or is before the Court.

The petitioner earnestly contends that the words "reserve funds" must be given their technical meaning instead of their general meaning. While we believe that the opinion of the Circuit Court of Appeals upon this point is sound, yet if we concede, for the purposes of this argument, that the petitioner's argument should prevail, the decision in this case must be the same. The technical meaning of "reserve funds" was clearly established at the trial of the case in the District Court, as above set forth, and in view of this uncontradicted testimony, we submit that the decision was correct. Whether we give the words "reserve funds" their general meaning or their technical meaning, they must be held to include the unearned premium reserve and the reserve for unpaid losses.

If, hereafter, it is contended that these words include reserves for liabilities of other descriptions, such questions will be passed upon by the courts, but, we submit, they are not now at issue.

(b) The petitioner's second proposition is that the interpretation placed upon the insurance laws of Pennsylvania by the Insurance Department of that State is erroneous, and furthermore, that the Insurance Commissioner is not charged with the duty of determining what constitutes the "reserve funds" of an insurance company.

A careful reading of the Act of the Pennsylvania Legislature of June 1, 1911 (P. L. 607), clearly indicates that the law contemplates that insurance companies "other than life insurance" shall maintain a reserve for unpaid losses. Section 9 makes it the duty of the Insurance Commissioner to charge against the company "as a liability the re-insurance and loss reserves." It is true that the act does not prescribe in detail the method in which the "loss reserve," or, as it is more commonly called, the "reserve for

unpaid losses," shall be calculated. This omission was clearly explained by the Deputy Insurance Commissioner as follows (R. 60):

> "Not exactly there, because you take the Act of 1911, and it says that 'the Insurance Commissioner after having charged the unearned premium reserve and the reserve for losses as defined above.' Now, it does not define specifically how you are going to calculate the outstanding losses of a fire insurance company because they are easily ascertainable, but it does say how you shall calculate the losses of other classes of insurance companies that are not so easily determinable. But it goes on to say that after calculating the unearned premium reserve and reserve for unpaid losses, and other liabilities, and having found the company's capital impaired, you shall do so and so. Now, while it does not specifically say how you shall calculate the losses of a fire insurance company, it applies to all insurance companies. It does not apply to just those casualty companies."

And again he says (R. 61):

> "Now, it does not apply to just the companies doing mercantile lines of business, or casualty lines of business, but, of course, we have got to calculate the unpaid claims of every insurance company. There are specific methods of calculating the unpaid claims of certain classes of insurance companies, where it is not easily determinable. But where you come to a fire and marine insurance company, where it is easy to determine, we calculate the unpaid claims of the company. The law does not specifically say how we shall do it. I do not take it, though, that it does not mean that the company does not have to reserve anything for unpaid claims, because going on with that section it says that 'if any company does not have the reserve for unpaid

claims, as calculated above,' and so forth, that the Commissioner shall proceed."

We respectfully submit that the District Court and the Circuit Court of Appeals were right in accepting the interpretation placed upon this law by the Insurance Department of Pennsylvania and enforced by that department against the respondent.

An examination of the above-quoted Act of June 1, 1911 (P. L. 607), shows that the entire responsibility for fixing and calculating the reserve funds of fire and marine insurance companies is by law imposed upon the Insurance Commissioner. Sections 7, 8 and 9 explicitly make it the duty of the Insurance Commissioner to calculate the amounts of reserves that the companies must maintain. A failure by any company to maintain the reserve required by the Insurance Commissioner can be punished by imposing upon the company the severe penalties prescribed by the insurance laws of Pennsylvania. For this purpose, the Insurance Commissioner is vested with broad powers. We submit, therefore, that the construction placed upon the statute by the officers charged with the duty of executing it was rightly given great weight by the Circuit Court of Appeals.

It is further suggested in the petitioner's brief (p. 16) that to permit the respondent to deduct additions to its reserve for unpaid losses might allow it to avoid taxation by again deducting the loss when paid. This, we submit, shows a fundamental misconception of the questions at issue. The respondent is not claiming the right to deduct the amount of its unpaid losses and claims which have occurred within the year. No such right is given under the Corporation Tax Law. The mere happening of a loss does not mean that the amount of the reserve for unpaid losses and claims is *pro tanto* increased over and above the amount of such reserve for the preceding year. The reserve is made

up of all of the unpaid losses and claims, and net additions are made thereto only when the total amount of the reserve exceeds the amount thereof in the preceding year. Such net additions do not represent the unpaid losses and claims which have accrued within the year, and there is no basis for the suggestion that the deduction of the amount of any net additions to the reserve for unpaid losses will permit the insurance company to again deduct the same amounts when the losses actually occur.

In conclusion we respectfully submit that the petition should be dismissed.

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No. 475

In the Supreme Court of the United States

OCTOBER TERM, 1916

WILLIAM McCOACH, COLLECTOR OF INTERNAL REVENUE, PETITIONER

VS.

INSURANCE COMPANY OF NORTH AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT

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WILLIAM McCOACH
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v.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT

ARGUMENT

1. The Act of Congress of August 5, 1909, imposing a special excise tax on corporations recognizes the peculiar nature of the insurance business

In *Flint v. Stone Tracy Co.*, 220 U. S. 108, at page 151, this Court said:

> "The tax under consideration, as we have construed the statute, may be described as an excise upon the particular privilege of doing business in a corporate capacity, *i. e.*, with the advantages which arise from corporate or quasi-corporate organization; or, when applied to insurance companies, for doing the business of such companies."

The measure of the tax is the net income of the corporation, determined by making certain specified deductions from gross income. As to all classes of corporations, other than insurance companies, these deductions (except a reasonable allowance for depreciation of property) are of sums actually paid out by the corporation within the year. The basis of the tax is the free income of the corporation which could be distributed in dividends, or otherwise dealt with, as the corporation might see fit. The Congress recognized, however, that the nature of the insurance business made it necessary for insurance companies to establish and maintain reserve funds. Therefore, to permit an insurance company to deduct merely "all losses actually sustained within the year and not compensated by insurance or otherwise" would not cover all sums which an insurance company had to eliminate from its income in order to make provision for the ordinary losses of the insurance business. To meet these losses insurance companies must maintain reserve funds, and insurance companies were, therefore,

permitted by the act to make the additional deduction of "the net addition, if any, required by law to be made within the year to reserve funds." Any net addition required by law to be made to the reserve funds of an insurance company is withdrawn from the control of the company and cannot be dealt with by the company as part of its net income.

2. The position of the Respondent under the insurance laws of Pennsylvania

(*a*) *The statutes.*

In addition to the statutes of Pennsylvania quoted on pp. 4, 5 and 6 of the petitioner's brief, we direct the attention of the Court to certain other statutory provisions defining the powers of the Insurance Commissioner of Pennsylvania, referred to in the opinions of the courts below. The Pennsylvania Act of June 1, 1911, (P. L. 607) provides in Section 15 as follows:

> "Every insurance company shall annually, on or before the first day of March, file in the office of the Insurance Commissioner a statement which shall exhibit its financial condition on the 31st. day of December of the previous year, and its business of that year. The Commissioner shall annually furnish to each of the insurance companies authorized to do business in this Commonwealth blanks, in such form as he may adopt, for their annual statements; and

he may make such changes, from time to time, in the form of the same as shall seem to him best adapted to elicit from them a true exhibit of their financial condition; * * * Any company which neglects to make and file its annual statement in the form or within the time herein provided shall forfeit $100 for each day during which such neglect continues, and, upon notice by the commissioner, its authority to do new business shall cease while such default continues. For wilfully making a false annual or other statement required by law, an insurance company, and the persons making oath to or subscribing the same, shall severally be punished by a fine of not less than $500, nor more than $5,000. A person who wilfully makes oath to such false statement shall be guilty of perjury."

Paragraph first of Section 4 of the said act makes it the duty of the Insurance Commissioner

"to see that all the laws of this Commonwealth respecting insurance companies and the agents thereof are faithfully executed; and for that purpose he is hereby given authority to make examinations of insurance companies, home or foreign, whenever he determines it to be necessary or expedient; * * * and, for the purpose of such examinations, he or his deputy, or his examiners, shall have free access to all the books and papers of any such company which relate to its business, and to the books and papers kept by any of its agents, and may summon and

administer the oath to, and examine as witnesses, the directors, officers, agents and trustees of any such company, and any other person, relative to its affairs, transactions, and condition."

Paragraph second of Section 4 of the said act reads:

"He shall publish the result of his examination of the affairs of any company, whenever he deems it for the interest of the policy holders so to do. He shall suspend the entire business of any insurance company of this Commonwealth, and the business within this Commonwealth of any insurance company of another state, or foreign government, during its non-compliance with any provision of law obligatory upon it, or whenever he shall find that its assets are insufficient to justify its continuance in business, by suspending or revoking its certificate of authority granted by him."

Paragraph third of Section 4 of the said act reads:

"Whenever the Insurance Commissioner shall find that any insurance company of this Commonwealth is insolvent or fraudulently conducted, or that its assets are not sufficient for carrying on the business of the same, or during any non-compliance with the provisions of this act, he shall communicate the facts to the Attorney General, whose duty it shall be, after hearing, to apply to any court in this Commonwealth having jurisdiction, or in vacation to any of the

judges thereof, for an order requiring the company to show cause why its business should not be closed * * * ."

The powers of the Insurance Commissioner are further extended by the Pennsylvania Act of June 1, 1911, (P. L. 599) which provides in Section 1 as follows:

"That whenever any domestic insurance company, association, society, or order, including all corporations, associations, societies, and orders which are subject to examination by the Insurance Commissioner, or which are doing or attempting to do, or representing that they are doing, the business of insurance in this Commonwealth; or which are in process of organization intending to do such business therein, (a) is insolvent; or * * * (e) is found, after an examination, to be in such condition that its further transaction of business will be hazardous to its policy holders, or to its creditors, or to the public; * * * the Insurance Commissioner may, through the Attorney General, apply to the Court of Common Pleas of Dauphin County, or to the court of any county in which the principal office of such corporation is located, for an order directing such corporation to show cause why the Insurance Commissioner should not take possession of its property and conduct its business, and for such other relief as the nature of the case and the interests of its policy holders, creditors, stockholders, or the public may require."

Prior to the revision of the insurance laws of Pennsylvania in 1911, the Insurance Commissioner had, under earlier acts, substantially the same powers.

(*b*) *Requirments of the Pennsylvania statutes.*

The system for the enforcement of these statutes is well summarized in the opinion of Judge McPHERSON (R. 67). In each year the respondent, together with all other insurance companies doing business in Pennsylvania, is compelled to file an annual statement in a form prepared and required by the Insurance Department. The purpose of this statement is to elicit from the companies a true exhibit of their financial condition in order that the Insurance Commissioner may determine whether or not each company has sufficient assets to meet its liabilities in accordance with the requirements imposed by the Insurance Department. Heavy penalties are imposed for failure to file these statements and for making a false statement. By Section 15 of the Act of June 1, 1911, (see p. 3, 4 of this brief) the Insurance Commissioner is authorized to exact this statement "in such form as he may adopt." In the form adopted by the Insurance Commissioner of Pennsylvania the respondent is required to make a statement of its liabilities. (We have reprinted as an appendix to this brief the fifth page of the respondent's annual statements for the years 1909, 1910 and 1911, containing the liabilities required to

be reported.) The first liability is "Net Amount of Unpaid Losses and Claims." The Secretary and Treasurer of the respondent explained this item as follows (R. 33):

> "Q. Will you explain to the Court the general nature of the items which make up the net amount of unpaid losses and claims of the company, as shown by the annual reports of the company to the Insurance Commissioner of Pennsylvania for the years 1910 and 1911?
>
> A. That represents the aggregate of what we call reservations commonly in the office for the individual losses as they are reported to us and entered in our books.
>
> Q. That means fire or marine losses, which have accrued but which have not yet been paid and settled? Is that right?
>
> A. That is right."

The second item of liabilities reported is "Total Unearned Premiums." This item is calculated by the method prescribed in Section 7 of the Pennsylvania Act of June 1, 1911, (P. L. 607) see p. 4 of petitioner's brief. *It is to be noted that these two items of liability have to do with the insurance or policy obligations of a going insurance company.* Then follow liabilities of all kinds, including interest due or accrued, unpaid dividends, salaries, rents, taxes, commissions, brokerage, etc.

If an insurance company makes a report showing insufficient assets to meet these liabilities, the

Insurance Commissioner can suspend the business of the company by revoking its certificate of authority to do business.

It therefore appears that whenever the net amount of the respondent's "unpaid losses and claims" is increased, the company must withhold out of its gross income sufficient funds to cover such increase.

3. An addition to "net amount of unpaid losses and claims" is a net addition required by law to reserve funds.

The Excise Tax Act does *not* authorize the deduction of the net addition made to reserve funds required by law to be maintained. The deduction allowed is "the net addition, if any, required by law to be made within the year to reserve funds." The question therefore is whether any particular addition to reserve funds was required by law. The act recognizes the existence of reserve funds and makes no attempt to define them. This makes it necessary to determine what are the reserve funds of a fire and marine insurance company. Upon this question the opinions of Judge DICKINSON in the District Court (R. 60) and of Judge MCPHERSON in the Circuit Court of Appeals (R. 67) are in conflict. Judge DICKINSON concluded that the words "reserve funds" as used in the Tax Act have a technical meaning and include only the policy or insurance obligations of the company. Judge MCPHERSON

held that Congress used the words "reserve funds" in their general meaning so as to include any liability against which a company is compelled to reserve assets.

A. The respondent's contention throughout this case has been that the words "reserve funds" were used by Congress in their technical meaning as applied to the business of insurance companies. In *State v. Vandiver,* 213 Mo. 187, cited on p. 6 of petitioners brief, at p. 213, the Court says "The word 'reserve' in connection with the subject of life insurance, has a technical meaning * * * " This is equally true in connection with the subject of fire insurance. To establish the meaning of "reserve funds" the respondent called S. W. McCulloch, who has been connected with the Insurance Department of Pennsylvania for over thirty years as Deputy Insurance Commissioner and as Insurance Commissioner (R. 35, 36), who testified that the established meaning of reserve funds of an insurance corporation is, "First, the amount which should be set aside for the losses that occurred and had not been paid or determined; and, second, the amount that is to be returned to policyholders or used as re-insurance on policies that have not matured." The testimony of Mr. McCulloch was corroborated by that of Mr. M. G. Garrigues (R. 54) who has been in the fire insurance business for over forty-five years. This testimony was admissible to interpret the meaning of the technical words used in the act:

Mutual Benefit Life Insurance Company v. Herold, 198 Fed. 199, *People v. Borda,* 105 Cal. 636, *Hockett v. State,* 105 Ind. 250, *Greenleaf on Evidence,* (16th Ed.) § 293, 295. See also *Maryland Casualty Co. v. U. S.* Court of Claims, Feb. 12, 1917 in which both parties called witnesses to give similar testimony.

This interpretation of "reserve funds" shows that they include the company's liabilities to policy holders. As the company is in the business of insurance these are its principal liabilities, and the purpose of the "reserve funds" is to make adequate provision to protect the policy holders (R. 48). In *Mutual Benefit Life Insurance Co. v. Herold,* 198 Fed. 199, 212 it was agreed that the word "reserve" means the sum which the company must have on hand to meet its *policy* obligations, and it was held that the company's liability on life insurance policies payable in instalments is properly represented in the company's reserve funds. Additions to the amount of such liabilities were, therefore, held to be deductible from gross income, and free from taxation under the Act of 1909. This decision was affirmed in 201 Fed. 918 and a petition for a writ of *certiorari* was dismissed by this Court 231 U. S. 755.

The original charter of respondent which was offered in evidence at the trial of the case (R. 34) was granted by the Act of the Pennsylvania Legislature of April 14, 1794, (P. L. 129). Section 5 of the said act provides:

> "That the said company shall be obliged by force and virtue of this act, from time to time, to cause such a stock of ready money to be provided and reserved as shall be sufficient to answer all just demands upon their policies of insurance for any losses which shall happen."

The respondent's charter was amended on February 2, 1910, (R. 34) and this provision was dropped because between 1794 and 1910 the Commonwealth had taken over the supervision and regulation of the insurance business and this provision was therefore unnecessary. Clearly, under this definition of the respondent's reserve funds a "reserve for unpaid losses" was necessary.

The interpretation of the words "reserve funds" for which the respondent contends is sustained by the recent decision of the Court of Claims of the United States in *Maryland Casualty Company v. the United States,* decided February 12, 1917. In the course of his opinion Judge BOOTH said (Advance Sheets, p. 23):

> "Legal reserve funds are those sums required by state laws to be maintained by insurance companies to secure its liabilities upon policies written."

And again (at p. 25):

> "A reserve fund is necessarily a certain portion of the company's income; it fluctuates as its volume of business increases or decreases,

> and it is difficult to trace its creation to the company's income in any specific year. Nevertheless, it is nothing more or less than the setting aside of certain portions of the company's assets accumulated during the course of business from its income, in order to secure the payment of certain liabilities incurred * * * . The Federal Taxing Act doubtless exempted net additions to reserve funds upon the theory of their actual reservation, the inability of the company to avail itself of these sums in the transaction of its current business affairs, aside from its specific liabilities upon insurance written * * * ."

The Court held that other liabilities of an insurance company, such as unpaid taxes, rents, commissions, etc., do not form a part of its reserve funds.

None of the cases cited on page 6 of the petitioner's brief involve a decision or discussion of the question as to what is included in the reserve funds of a fire and marine insurance company.

The Pennsylvania Insurance Laws were evidently drawn in the light of the established practice and requirements of the Insurance Department. As was clearly brought out in the cross-examination of Mr. McCulloch (R. 39 to 49) the acts undertake to specify how certain reserves shall be calculated in cases where the proper amounts of such reserves are difficult to determine. The calculation of the "reserve for unpaid losses" of a fire and marine company is a simple matter for which it would have

been superfluous to prescribe an exact method. (R. 42). A careful reading of the acts makes it clear that they contemplate and require the maintenance of the "reserve for unpaid losses" or "loss reserve" as well as the "unearned premium reserve" or "re-insurance reserve." The provisions of the Act of June 1, 1911, (P. L. 607) are set forth on pp. 4, 5 and 6 of petitioner's brief. Section 7 of the said act provides the method for calculating the "reserve for re-insurance" for casualty and fire and marine companies. Section 8 prescribes the method for calculating the "reserve against unpaid losses" of casualty companies. Section 9 makes it the duty of the Insurance Commissioner to charge "as a liability the re-insurance and loss reserves, as above defined for insurance companies of this commonwealth other than life." To these reserve liabilities are then to be added all other debts and claims against the company.

The interpretation placed upon these statutes by the Insurance Department of Pennsylvania is clearly explained and justified in the testimony of Mr. McCulloch (R. 37 to 49). As stated in the opinion of the Circuit Court of Appeals (R. 69) the uniform construction of a statute adopted by the highest administrative authorities is entitled to great respect and should not be disregarded unless it is clearly erroneous: *U. S. v. Burkett,* 150 Fed. 208, 212, *U. S. v. Healey,* 160 U. S. 136, *U. S. v. Hermanos,* 209 U. S. 339.

We submit that the "reserve funds" of the respondent include the amounts of the "unearned premium reserve" and the "reserve for unpaid losses," that the insurance laws of Pennsylvania as interpreted and enforced by the Insurance Department contemplate and require the maintenance of these reserve funds, and that an increase in the amount of unpaid losses and claims is an addition required by law to reserve funds.

B. The opinion of the Circuit Court of Appeals placed a broader interpretation upon the words "reserve funds" than was contended for by the respondent. The Court held that "reserve funds" "include generally such funds as must be reserved to meet liabilities, whether they be contingent or already adjusted." (R. 67), and that the increase in any sum which the company is required from year to year to carry as a liability is an addition required by law to reserve funds. There is much to be said for this view which is clearly and forcibly set forth in the opinion of Judge McPherson. There is no doubt but that assets required to meet liabilities are effectively withdrawn from the control of the company and therefore reserved for this particular purpose. The respondent's contention has been, and now is, that the "reserve funds" of an insurance company must in any event include all of the company's insurance or policy liabilities.

4. To permit Respondent to deduct additions to its "reserve for unpaid losses" would not deprive the Government of the tax on any income actually enjoyed.

The petitioner argues that the exemption claimed would involve a deduction for a loss not actually paid contrary to the general intention of the statute (p. 8 of petitioner's brief). The Tax Act specifically recognizes the peculiar nature of the insurance business and permits the deduction of additions to reserve funds. The reason for this is that the reserve funds are withdrawn from the company's control and cannot be enjoyed and dealt with by the company as in the case of free income over and above the reserve requirements. The intent of the statute is clearly to make an exception in the case of insurance companies.

That this works no injustice to the Government is demonstrated by the case of *Maryland Casualty Company v. United States,* Court of Claims, February 12, 1917. Mr. W. B. Whipple, the auditor of returns of insurance companies in the Department of Internal Revenue, testified in that case (evidence for defendants, p. 174) that insurance companies have been without exception compelled to pay a tax on the release of all reserves. That is to say, if the amount of the respondent's "reserve for unpaid losses" should in any year be less than in the preceding year, the Government would assess and

collect a tax upon the amount of such released reserve upon the theory that such amount was an addition to the income of the company during the year in which it was released. The Court of Claims sustained the right of the Government to do this (see opinion of BOOTH, *J.*, pp. 25 and 26, Advance Sheets). It is true, as stated in the petitioner's brief, (p. 14) that as long as the "reserve for unpaid losses" continues to increase the Government is deprived of the tax on the amount of such increases, but it is also true that the company is at the same time deprived of the full control and enjoyment of that portion of its income which is reserved for this purpose.

The petitioner charges in his brief (p. 14) that the "reserve for unpaid losses" furnishes a convenient hiding place for a too conspicuous surplus. It is obvious that no matter what the decision of this Court may be, the respondent's accounts will remain in precisely the same condition. The respondent will be compelled to continue to report to the Insurance Department of Pennsylvania the amount of its unpaid losses and claims and to continue to reserve sufficient assets to cover them. Any suggestion that the reserve for unpaid losses and claims was created for the purpose of inflating the reserve funds of the respondent in order to escape taxation is unwarranted and without foundation. That the respondent has been compelled since 1876 to report the amount of its unpaid losses and claims to the Insurance Department of Pennsylvania and to reserve

sufficient assets to cover them appears in the opinion of the Circuit Court of Appeals (R. 68). The relation between the respondent's reserve funds and its surplus will remain undisturbed by the outcome of this case and it is impossible to hide any part of the surplus under the heading of "Reserve for Unpaid Losses." The experience of fire insurance companies and their policy holders following the San Francisco conflagration amply justifies the respondent in maintaining an adequate surplus over and above all fixed liabilities.

The only question for decision is whether the respondent shall be permitted to deduct from income sums which are admittedly withdrawn from its control in precisely the same manner and to precisely the same extent as in the case of the re-insurance or unearned premium reserve.

In conclusion we respectfully submit that the judgment of the Circuit Court of Appeals should be affirmed.

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